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Ardmore: Some Reflections on the "Practical Approach" to Identifying the Source of an Interest Payment

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Abstract

This article seeks both to trace the origins of the "practical approach" taken by the Court of Appeal in Ardmore Construction Ltd v HMRC *to establishing the source of interest and also, by reference in particular to the experience of South Africa and Australia, to test whether that approach augurs well.*

On one reading, *Ardmore Construction Ltd v HMRC* (*Ardmore CA*)[1] may perhaps be seen as little more than the Court of Appeal measuring arguments put forward on behalf of the taxpayer against the test in *Edwards (Inspector of Taxes) v Bairstow*[2] and concluding that the hurdle to set aside the Tribunals' decisions had not been met.[3] Indeed, Arden LJ, with whom Sales LJ and Leggatt LJ both agreed, said:

> "Ardmore has to satisfy this Court that the Tribunals were wrong in the sense that they left a material factor out of account or took a matter into account that should have been left out, or misdirected themselves in law or fact or reached a perverse conclusion. I do not consider that Ardmore discharges that burden."[4]

Yet, on 12 June 2019, just under a year after the Court of Appeal handed down its judgment in *Ardmore CA*,[5] HMRC updated their published guidance[6] as to how HMRC determine whether interest has a UK source. Previously, HMRC had taken the view that although all the facts and circumstances should be considered the debtor's residence was the "most important" factor.[7]

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[1] *Ardmore Construction Ltd v HMRC* [2018] EWCA Civ 1438.

[2] *Edwards (Inspector of Taxes) v Bairstow* (1953–1956) 36 TC 207 (HL).

[3] That was, the author understands, a view towards which one of this article's anonymous reviewers tended. However, the change made by HMRC in June 2019 to HMRC's published practice, shortly after that review took place, indicates that HMRC take the view that *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438 did indeed move the goalposts. The author is very grateful, nonetheless, to both anonymous reviewers and has endeavoured to do the aforementioned reviewer's comments justice. Compare C. Yorke, "Ardmore: withholding and UK source", *Tax Journal*, 5 July 2018, 10, 11 where the author concluded that it was possible to read *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438 as not contradicting HMRC's pre-June 2019 guidance.

[4] *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438 at [40]–[41].

[5] *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438. The Court of Appeal handed down its judgment on 21 June 2018.

[6] HMRC, Internal Manual, *Savings and Investment Manual* (HMRC, SAIM) (originally published 19 March 2016), SAIM9090.

[7] As at 8 June 2019, SAIM9090 included the following statement: "HMRC consider the residence of the debtor to be most important because this, along with the location of the debtor's assets, will influence where the creditor will sue for payment of the interest and repayment of the loan. 'Residence' in these circumstances is not the same as tax residence. Residence of the debtor is residence for the purposes of jurisdiction." The National Archives, HMRC,

HMRC's updated guidance modifies that view and, describing the multifactorial approach adopted by the House of Lords in *National Bank of Greece SA Appellants v Westminster Bank Executor and Trustee Co (Channel Islands) Ltd Respondents* (*National Bank of Greece HL*)[8] as having been "reinforced" by the Court of Appeal's decision in *Ardmore CA*,[9] dispenses with the primacy that had previously been accorded to the place where a debtor is resident.

This article will seek to tease out how *Ardmore CA*[10] may be said to "reinforce" the use of the multifactorial approach. In doing so, this article will both travel back in time as far as the early 20th century and also examine the more recent experience of other jurisdictions (in particular Australia and South Africa[11]) with determining the source of interest. That experience, it will be argued, indicates that applying what Arden LJ referred to as a "practical approach"[12] may be far from straightforward and, however superficially attractive, is likely to have undesirable consequences; at least if value is placed upon achieving certainty of outcome (that is, with a certain result proving elusive prior to the First-tier Tribunal (FTT) being asked to weigh all the factors).

The facts in *Ardmore*

The facts in *Ardmore* can be stated fairly briefly.

The trustees of two trusts, which were each resident in Gibraltar, lent sums, on an unsecured basis, to a UK incorporated and tax resident company (Ardmore Construction Ltd (Ardmore CL)). Ardmore CL carried on a construction business wholly in the UK. The terms of the loans made by the trustees to Ardmore CL provided that all payments in respect of the loans should be made to an account of each trustee with a non-UK resident subsidiary of the National Westminster Bank in Gibraltar (or such other bank in Gibraltar as might be notified to the borrower from time to time) and that all payments (including of interest) should be paid from a source outside the UK. The loans were governed by the laws of Gibraltar and the parties submitted to the exclusive jurisdiction of the Gibraltar courts. The trustees of each trust were put in funds to make the loans by a British Virgin Islands (BVI) company, the ordinary shares in which were owned by each trustee. The beneficiary of each trust was a UK resident individual who was a director of Ardmore CL and the owner of 50 per cent of Ardmore CL's share capital. Each BVI company issued "A" redeemable preference shares to Ardmore CL. Ardmore CL funded the

[ARCHIVED CONTENT] SAIM9090, HMRC, Internal Manual, *Savings and Investment Manual*, "Duty to deduct tax from interest with a UK source" (archived 8 June 2019), available at: *https://webarchive.nationalarchives.gov.uk/20190608010603/https://www.gov.uk/hmrc-internal-manuals/savings-and-investment-manual/saim9090* [Accessed 6 February 2020].

[8] *National Bank of Greece SA Appellants v Westminster Bank Executor and Trustee Co (Channel Islands) Ltd Respondents* [1971] AC 945 (HL).

[9] *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438.

[10] *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438.

[11] Compare the contribution of UK tax law to Hong Kong tax law, as to which see M. Littlewood, "The Legacy of UK Tax Law in Hong Kong" [2008] BTR 253, which broaches the question whether the experience of Hong Kong, where a model of income tax legislation has been retained which resembles the position in the colonies in the 19th century rather than the current state of the law in the UK and other developed ex-colonies, suggests that the process of tax law reform in the rest of the developed English-speaking world over the last 100 years or so is better characterised as progress or as degeneration.

[12] *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438 at [34], [37] and [39].

subscription for the preference shares from its general working capital, said to arise from the profit of its UK trade.

The decisions of the Tribunals in *Ardmore*

Counsel for the taxpayer in *Ardmore Construction Ltd v HMRC* (*Ardmore FTT*)[13] sought to persuade the FTT that the source of interest was located in the place where the credit was provided; it being agreed between the parties that the test for the source of interest was distinct from the source of trading income and also distinct from the *situs* of the debt. The FTT reviewed a range of Commonwealth and Privy Council cases which had been put before it for consideration, including the Privy Council's judgment in *CIR v Orion Caribbean Ltd (In Voluntary Liquidation)* (*Orion*) relating to the taxation of profits (including interest) derived from Hong Kong, in the course of which Lord Nolan recognised[14]:

> "the whole range of authority starting from the judgment of Atkin L.J. in *F L Smidth & Co v Greenwood (Surveyor of Taxes)* onwards, to the effect that the ascertaining of the actual source of income is a 'practical hard matter of fact', to use words employed, again by Lord Atkin, in *Rhodesia Metals (in liq) Ltd v Commissioner of Taxes* [1940] AC 774 at 789. No simple, single, legal test can be employed."

The FTT concluded that the scheme of taxation in other jurisdictions is so different from that in the UK that not much can profitably be derived from those cases. However, the FTT recognised that in the case of both those authorities and *National Bank of Greece HL*[15]

> "it appears that the court did consider and weigh a variety of, albeit different, factors including, e.g. the residence of the debtor, the residence of any guarantor, the location of any security, the situs of the debt, the proper law of the contract and the place of payment of interest".[16]

The FTT, rejecting the "place of credit" approach, concluded that a "multifactorial approach" should be applied. On this basis, Ardmore CL was UK resident, the situs of the debt (although not a determinative factor) was located where Ardmore CL was resident and the UK provided the source and origin of the funds as well as the place of enforcement of the debt.[17]

The Upper Tribunal (UT) heard the appeal by Ardmore CL together with a separate appeal, on different facts, by a Mr Perrin.[18] During its review of the case law, the UT followed the FTT's interpretation, as referred to above, of Lord Nolan's judgment in *Orion*[19] and drew attention to an example given by Lord Nolan of a simple loan by a Hong Kong corporation to a borrower in New York, where Lord Nolan indicated that[20]:

[13] *Ardmore Construction Ltd v HMRC* [2014] UKFTT 453 (TC) at [24].
[14] *CIR v Orion Caribbean Ltd (In Voluntary Liquidation)* [1997] STC 923 (Privy Council (Hong Kong)).
[15] *National Bank of Greece HL*, above fn.8, [1971] AC 945.
[16] *Ardmore FTT*, above fn.13, [2014] UKFTT 453 (TC) at [41].
[17] *Ardmore FTT*, above fn.13, [2014] UKFTT 453 (TC) at [42].
[18] *Ardmore Construction Ltd and Perrin v HMRC* (*Ardmore UT*) [2015] UKUT 633 (TCC).
[19] *Orion*, above fn.14, [1997] STC 923.
[20] *Ardmore UT*, above fn.18, [2015] UKUT 633 (TCC) at [36].

> "[T]here might be little difficulty in saying that the location of the source of the interest was New York. In such a case, however, there was no question of the source of the interest being determined by the place, Hong Kong, from which the creditor had undertaken the lending activity. By contrast, in a case such as *Orion* itself, where the activity constituted borrowing and on-lending for profit, and those activities had been carried on in Hong Kong by the Hong Kong corporation on behalf of its Cayman Islands subsidiary, it was that activity which constituted the source of the income, and the source was accordingly a Hong Kong source. *Orion* does not therefore support [the] argument. In the case of a simple debt, it points in the opposite direction towards the place of the borrower."

The UT observed that care must be taken in seeking to translate findings which are findings of fact, and made in the context of the laws of a different jurisdiction, to the domestic context in which findings fall to be made. Echoing (albeit without explicitly stating that that is what it was doing) the passage from Lord Atkin's judgment in *Rhodesia Metals Ltd (In Liquidation) v Commissioner of Taxes* (*Rhodesia Metals*)[21] to which the FTT had (as noted above) alluded, the UT concluded that:

> "Where the source of trading or business activity must be ascertained, an analysis as a practical hard matter of fact may give rise to a different result from the case of a simple debt."[22]

The UT upheld the decision of the FTT in *Ardmore FTT* (and, indeed, upheld the FTT's decision in *Perrin v HMRC* as well).[23]

The approach taken by the UT in the conjoined appeals was essentially that the ratio in *National Bank of Greece HL* was that the source of an obligation must be ascertained by means of a multifactorial enquiry having regard to "all the circumstances and all the relevant factors"[24] and

[21] *Rhodesia Metals Ltd (In Liquidation) v Commissioner of Taxes* [1940] AC 774 (Privy Council (South Africa)) at 789.

[22] *Ardmore UT*, above fn.18, [2015] UKUT 633 (TCC) at [39]. The UT also considered the South African case of *Commissioner for Inland Revenue v Lever Brothers and another* (*Lever Brothers*) 14 SATC 1; [1946] AD 441, of which more will be said below. The Tribunal concluded (at [41]): "The finding, in such a case, that it is not the debt that is the source of the interest, but the activities of the creditor which earned the income, cannot be regarded as a finding of principle, applicable to all cases. Any argument that it were such would be bound to fail, in a UK context, as it would be contrary to the binding authority of the *Greek Bank* case. The South African court, in rejecting one argument that there was a legal rule determining source, was not attempting to substitute another such rule."

[23] *Ardmore UT* , above fn.18, [2015] UKUT 633 (TCC) at [90]–[91] (for Ardmore CL) and [65]–[68] (for Mr Perrin); *Ardmore FTT*, above fn.13, [2014] UKFTT 453 (TC); *Perrin v HMRC* [2014] UKFTT 223 (TC).

[24] *Ardmore UT*, above fn.18, [2015] UKUT 633 (TCC) at [53].

It is questionable whether the UT's identification of the ratio in *National Bank of Greece HL*, above fn.8, [1971] AC 945 was strictly speaking sound, or whether the Tribunal was correct in its assertion that the House of Lords' decision was binding on the Tribunal in determining the source of interest on a debt owed by an original debtor (as opposed to a guarantor).

M. Gammie, "An Older Tale of Default on Greek Bonds" in J. Tiley (ed.), *Studies in the History of Tax Law* (Hart Publishing, 2012), Vol.5, 359–379 commented that: "The leading case on the topic is usually regarded as the *National Bank of Greece* case…In fact, careful consideration of the arguments reveals that the case is authority for the correct source of interest paid by a guarantor [namely, the underlying bond] rather than the question of whether that interest paid was UK or foreign income."

See also J.F. Avery Jones, "Commentary on Ardmore Construction Ltd v HMRC" [2014] *International Tax Law Review* (Pt 6) 992 where attention is drawn in particular to the submission of Mr Heyworth Talbot QC (for the successor

that there was no hierarchy of materiality or weight in respect of those factors.[25] It followed that no single factor determined the source of an obligation. The legal *situs* of debt (including a specialty debt) was irrelevant.[26] In a "normal" case of a "simple loan" the place of the creditor's "underlying activity" was not relevant.[27]

By reference to the facts in *National Bank of Greece HL*,[28] the following factors either bore no weight, or did not outweigh the factors referred to by Lord Hailsham[29]: the creditor's residence; the place where credit was advanced; the place of payment of interest; the existence of a moratorium on a creditor's right to sue and enforce security against the debtor; the jurisdiction of enforcement; the proper law of the contract; and the substitute guarantor's place of business. The place of a debtor's residence, in the UT's view, although a "material" factor was not the most important factor; albeit that the place of residence was a factor regardless of whether the parties may bring proceedings in that jurisdiction.[30]

However, if a debt arose in the course of a trade, that trade "might" be regarded as the source of interest; in "special circumstances" the source of interest might not be determined by reference to "normal" factors.[31] In this context, the UT referred to the South African case of *Commissioner for Inland Revenue v Lever Brothers and another* (*Lever Brothers*)[32] (of which more is said below) in which an original (Dutch) debtor was substituted by another (South African) debtor and the source of the interest was held not to be in South Africa; in *Lever Brothers*, the involvement of the substitute debtor was the only nexus with South Africa and the South African Treasury had consented to the substitution on the condition that neither interest nor capital were paid out of South African funds.

The Court of Appeal's decision in *Ardmore CA*

By the time the Court of Appeal came to consider the source of interest in *Ardmore CA*,[33] the parties had agreed that the correct test to apply was a "multifactorial" test. The question had seemingly evolved to become: what did that mean? As Arden LJ put it:

> "The issue is how the source principle is to be applied to interest paid on a foreign loan in this case. There is no universal test for applying the source principle: in this case, using the language of the day, the test has been described as 'multifactorial' and thus as involving an overall assessment of the situation."[34]

guarantor) in *National Bank of Greece HL*, above fn.8, [1971] AC 945, in the course of which Counsel stated (at 952): "It is not disputed that if the claim had been against the principal debtor and there had been no moratorium in Greece and if the claim had been for interest under the terms of the bond, the source of the income would have been foreign."

It is, equally, doubtful whether the Tribunal was correct to refer to *National Bank of Greece HL*, above fn.8, [1971] AC 945 as authority with respect to the weight (or lack of weight) to be given to the particular factors.

[25] *Ardmore UT*, above fn.18, [2015] UKUT 633 (TCC) at [29]–[30] and [53].
[26] *Ardmore UT*, above fn.18, [2015] UKUT 633 (TCC) at [29]–[30].
[27] *Ardmore UT*, above fn.18, [2015] UKUT 633 (TCC) at [43].
[28] *National Bank of Greece HL*, above fn.8, [1971] AC 945.
[29] *National Bank of Greece HL*, above fn.8, [1971] AC 945 at 954–955.
[30] *Ardmore UT*, above fn.18, [2015] UKUT 633 (TCC) at [52]–[53].
[31] *Ardmore UT*, above fn.18, [2015] UKUT 633 (TCC) at [40]–[41] and [43].
[32] *Lever Brothers*, above fn.22, 14 SATC 1; [1946] AD 441.
[33] *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438.
[34] *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438 at [1].

Arden LJ went on to observe that the "multifactorial test does not help the Court choose which the determinative factors are".[35] Arden LJ commented that in *Ardmore* the FTT and the UT had "looked to the substantive matters rather than theoretical factors, such as causative link and governing law" and so applied a "practical approach".[36] Quite what that "practical approach" involved was signalled in a passage which merits citing in full:

> "The answer to this particular problem is I think to be found in a number of passages in the decided cases, but I will choose the brief and elegant judgment of Lord Atkin, giving the advice of the Privy Council in *Rhodesia Metals*[37], which was cited to the FTT…. Lord Atkin first made the point, which I would respectfully adopt, that great caution should be applied in adopting decisions on source from different legislative regimes, that what is the source depends to some extent on the perspective from which the question is asked, that it was not possible to provide a universal definition of 'source' and, most importantly, that the question had to be resolved by applying practical sense. I refer to this below as 'the practical approach.'"[38]

Arden LJ concluded that:

> "The Privy Council's reference to matters of fact means that the correct approach to applying the multifactorial test is to ask whether a practical person would regard the source as in this jurisdiction or elsewhere. I do not see any material difference between this approach and that of Lord Hailsham in the *National Bank* case. Lord Hailsham applied a matter of fact approach as opposed to an approach based on legal concepts and rules."[39]

Counsel for HMRC pressed the Court of Appeal as to the importance of having regard to the "underlying commercial reality" and Arden LJ accepted that lead, with a slight clarification[40]:

[35] *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438 at [33].
[36] *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438 at [43].
[37] *Rhodesia Metals*, above fn.21, [1940] AC 774.
[38] *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438 at [34].
[39] *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438 at [37].
Whether this is an entirely fair characterisation of the thinking which underpinned Lord Hailsham's approach may be a moot point. Appearing before the Court of Appeal in *Westminster Bank Executor and Trustee Co (Channel Islands) Ltd v National Bank of Greece SA* (*National Bank of Greece CA*) [1970] 1 QB 256 (CA) J.P. Warner, representing the Inland Revenue which was before the Court as *amicus curiae*, argued (at 267B) that the "basic test" for determining whether the payments are income arising in the UK was to be found in J.H.C. Morris, *Dicey and Morris on the Conflict of Laws*, 8th edn (London: Sweet & Maxwell, 1967), 508, r.79, on the determination of the *situs* of things. Although Lord Hailsham did not expressly refer to this line of argument, Lord Hailsham indicated that the starting point for his reasoning was Lord Herschell's statement in *Colquhoun v Brooks* (*Colquhoun*) (1889) 2 TC 490 (HL) and implicit in this quotation is a concern with jurisdiction. The natural corollary of *Colquhoun*, when one moves on from generalities relating to a state's taxing rights to analyse the source of a particular obligation, is that the first port of call (albeit not necessarily the final destination) should be private international law's approach to ascertaining the situs of a debt. Private international law concepts were seemingly considered in the context of *National Bank of Greece CA* and, indeed, private international law concepts were very much "in the air" as they permeated the entire saga of which that case formed merely part. Equally, however, Lord Hailsham's consistent reference to the "source of the obligation" (rather than the situs of the obligation) may be seen as intended to leave some space between private international law principles and the determination of whether a particular obligation should be subject to tax in the UK on a territorial principle.
[40] *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438 at [38].

> "Those words are appropriate to this case which concerns a commercial transaction but in other types of transaction one might ask which was the source from a practical, or realistic, point of view."

Arden LJ added that this "practical approach" was not merely multifactorial but[41]

> "also acutely fact-sensitive. The court or tribunal must examine all the available facts both singly and cumulatively."

It followed, Arden LJ continued, that an appellate court should be "slow to interfere" and that an appellant should therefore satisfy an appellate court that a tribunal was "wrong in the sense that they left a material factor out of account or took a matter into account that should have been left out, or misdirected themselves in law or fact or reached a perverse conclusion".[42] Thus:

> "In this case, however, the conclusion of the Upper Tribunal that the residence of the creditor should carry little weight cannot be criticised. The immediate search is for the source of the interest rather than a search indirectly for the source of the loan. The funds paid over as interest derived from funds generated in the UK. The activity of lending became passive once the loan was made, whereas the business of Ardmore was actively conducted to produce those funds. There was no default and the Gibraltarian exclusive jurisdiction and governing law clauses would only matter if there was default. The importance of those clauses is also undermined by the fact that the enforcement of any judgment following default on assets of Ardmore would be in the UK (and it is not necessary to go further than to note that all the available assets to meet the liabilities to the lender were in the UK). Furthermore, relative to the links with the UK, the links with Gibraltar were of an insubstantial kind: there was no evidence that they were backed up by any kind of other activity within Gibraltar, nor was it explained why it was necessary for the trusts to form companies in the BVI or what commercial purpose those companies served. The insubstantial nature of the transaction's connection with Gibraltar distinguishes this case from the *Philips* and *Rhodesia Metals* cases where there was a significant connection with the source (active business and mining claims respectively). I see no basis, therefore, for holding that the Tribunals left out of account any material factor or took any immaterial factor into account."[43]

The origins of the "practical approach" to source as a "practical hard matter of fact"

Although Arden LJ made it clear that she regarded Lord Atkin's judgment in *Rhodesia Metals*[44] as merely one instance of the courts taking what she referred to as a "practical approach"[45] to questions of source, Lord Atkin's reference to source as being "a practical hard matter of fact", which had already been noted by the FTT, was not explored in any detail by Arden LJ (indeed,

[41] *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438 at [39].

Expanding on this a little, Arden LJ in *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438 at [41], rejected HMRC's contention that some factors were irrelevant: "[O]n a multifactorial test a factor is still relevant even if it carries little weight."

[42] *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438 at [40].

[43] *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438 at [42].

[44] *Rhodesia Metals*, above fn.21, [1940] AC 774 at 789.

[45] *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438 at [34].

no such exploration was needed in order to dispose of Ardmore CL's appeal in accordance with *Edwards v Bairstow* principles). However, given the relative dearth of authority on how to approach identifying source, it is suggested that it may be helpful to take a slightly archaeological approach to Lord Atkin's formulation; that exercise will occupy the following paragraphs of this section.

The key passage in Lord Atkin's judgment, is as follows:

> "Their Lordships incline to the view quoted with approval from Mr. Ingram's work on South African Income Tax Law by de Villiers J. in his dissenting judgment: 'Source means not a legal concept, but something which a practical man[46] would regard as a real source of income'; 'the ascertaining of the actual source is a practical hard matter of fact.'"[47]

The quest to understand what a "practical man" would identify as a "practical hard matter of fact" as the source of interest begins with de Villiers J's judgment in the South African court from which the appeal to the Privy Council in *Rhodesia Metals* originated; and, more particularly, via Villiers J's judgment to "Mr Ingram's work on South African Income Tax Law".

Mr Ingram was, more properly, C.J. Ingram KC the second president of the Cape Tax Court and, although he may not be particularly familiar to UK practitioners, his contribution to South African tax law has been described by his modern biographer as "immeasurable" (and the man himself as "enigmatic").[48] Income tax had only been introduced in South Africa in 1914[49] and Ingram's book was, therefore, mining a rather new seam of law; this book, *The law of income tax in South Africa. A commentary on the Income Tax acts of South Africa, together with the acts relating to surtax* had been published in Johannesburg in 1933.[50]

This is what the passage in Ingram's book that had caught Villiers J's eye had to say in relation to the source of income[51]:

> "Source means not a legal concept, but something a practical man would regard as a real source of income…the ascertaining of the actual source is a practical hard matter of fact."

This passage repays some careful unpacking.

[46] Lord Atkin's "practical man" became, presumably in deference to the modern preference for gender neutrality, in Arden LJ's judgment a "practical person": *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438 at [37].
[47] *Rhodesia Metals*, above fn.21, [1940] AC 774 at 789.
[48] C.J. Ingram was born in 1879 in England, the son of a solicitor, and educated at Harrow before reading law at Brasenose, Oxford, after which he left for South Africa in 1902. From 1922 to 1949 Ingram seems to have been responsible for some 122 tax judgments, before retiring to Matlock in Somerset (in England) where he died in 1959. For Ingram's life, see further, A. Marais, "C J Ingram K.C.: Academic Pioneer and second President of the Cape Tax Court" in J. Hattingh, J. Roeleveld and C. West, *Income Tax in South Africa: The First 100 Years (1914 - 2014)* (Juta & Company (PTY) Ltd, 2016), 362–367.
[49] Income Tax Act No.28 of 1914.
[50] For a very helpful, more modern, review of the development of the South African law in relation to source—albeit focusing in particular on the source of income arising from the performance of personal services—see the commentary provided by J. Hattingh, "X v Commissioner for the South African Revenue Service [Case Number 14218]" (2018) 20 ITLR 658, 660–668.
[51] C.J. Ingram, *The law of income tax in South Africa. A commentary on the Income Tax Acts of South Africa, together with the acts relating to surtax* (Johannesburg: 1933), 66.

As a first step, this passage benefits from being set in the context of what Ingram had to say "generally" about source, which was as follows[52]:

> "Section 7(1) of the Act…lays down no special definition of the word 'source'.…the term must be interpreted in its ordinary every day meaning and in accordance with the construction placed upon it by the Courts. So far the South African Courts have shown little inclination to generalise on the subject. In Australia, where the principle of income *qua* source is also in vogue, it has been said that 'the question must be decided as a practical matter of fact - taking the substance of the transaction and disregarding the form'[53]. And again that 'Source means, not the legal concept, but something which a practical man would regard as a real source of income. Legal concepts must, of course, enter into the question when or how to consider to whom a given source belongs. But the ascertainment of the actual source of a given income is a practical hard matter of fact[54]."

Taking this archaeological approach a stage further, it is helpful to look under three further stones, which reveal that:

- South African tax law never really[55] adopted the approach of determining the source of interest as a "practical hard matter of fact" such as may be determined by a "practical man";
- the South African "deemed source" rules create a very different legislative context to that provided by UK legislation relating to the source of interest; and
- the "practical hard matter of fact" approach derived from Australian cases relates, not to the source of interest, but to the source of mining profits (which, as will become apparent, are a rather different kettle of fish to interest).

The following paragraphs look under each of these stones in turn.

First stone: the source of interest was never really determined, for South African tax law purposes, as a "practical hard matter of fact"

A convenient place to pick up the path trodden by the South African Courts is Innes CJ's decision in *Overseas Trust Co Ltd v Commissioner for Inland Revenue* (*Overseas Trust*).[56] This decision would be cited approvingly by Watermeyer CJ in the pivotal case of *Lever Brothers*[57] which we

[52] Ingram, above fn.51, 66.
[53] Ingram's footnote: "N B Rydge on the Commonwealth Acts at p;41, *cit. Adelong Gold Estates No Liability v Commissioner* (1922) SR. at p.203)."
[54] Ingram's footnote: "Rydge, *ibid. cit. Nathan v F. Commissioner of Taxes* (1918 C.L.R. 25 at pp.189 and 190)."
[55] Compare Roper J's attempted synthesis; in Roper J's view: "The question of the source of this is said to be 'a practical, hard matter of facts', or what 'a practical man would regard as a real source of income' (*Rhodesia Metals*, 1940 AD 432: *Lever Brothers*, 1946 AD 441). The 'practical man' is not further defined; but as he would need to have business experience and a grasp of income tax law and practice in order to decide such a question, it seems to me that in its practical application the phrase means nothing more or less than the judge, considering in practical way all the factors in the earning of the profit."
See *Transvaal Associated Hide and Skin Merchants (Pty) Ltd v The Collector of Income Tax* (*Transvaal*) BLR 1964–1967 207 (CA) at 215–216.
[56] *Overseas Trust Co Ltd v Commissioner for Inland Revenue* 1926 AD 444.
[57] *Lever Brothers*, above fn.22, 14 SATC 1; [1946] AD 441.

shall soon come to below, and instructively bears the clear marks of Australian jurisprudence that would be transmitted, through Ingram CJ's textbook on South African tax law and courtesy of Villiers J to Lord Atkin and, through Lord Atkin, to the Court of Appeal in *Ardmore CA*.[58]

Overseas Trust concerned the treatment of a financial and investment company, registered in Cape Town and Windhoek, that had been formed to take over 1. shares and debentures in mining companies in the South West African Protectorate,[59] 2. some shares in mining companies in the Union and 3. certain dividends and surplus assets of companies in liquidation, held by the Custodian of Enemy Property.[60] Ninety-seven per cent of Overseas Trust's share capital was owned by a Dr Luppert, who had established Overseas Trust and transferred those assets to it for less than half their market value. Overseas Trust had sold its assets for £32,628, including selling shares acting through brokers in Germany (at a price fixed by Overseas Trust) for a profit of £4,534. Innes CJ approached the question of the source of those profits,[61] in a passage that Watermeyer CJ would subsequently place reliance upon in *Lever Brothers*, as follows:

> "It remains to localise the source of the income. This is an enquiry of some considerable difficulty. This Court in *Commissioner of Taxes v Dunn & Co* (1918 A.D. p.607) looked at the place where capital was employed to earn income in determining the source of that income. And that seems to have been the general rule of the Australian Courts in construing an Act very similar in this point to our own (See *Rydge's Commonwealth Income Tax Act Annotated*, p. 43). Menzies Murray's *Income Tax Act Annotated* p.35, remarks that 'the source of any income may be said generally to be the location of the business, capital or service which produces the income. If this income-producer is located in the Union, then the particular income has been earned from a source in the Union.' That fairly expresses the result of the decisions, bearing in mind however that 'source' denotes origin, not location, and that capital which produces profit is located where it is employed. Now had these

[58] *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438.

[59] Today, the Republic of Namibia. In July 1915 German control of what had been the German colony of South West Africa ceased and the Treaty of Versailles, 1919, Art.22 provided for the former German colony to be governed under a League of Nations mandate bestowed upon the Union of South Africa (which then formed part of the British Empire).

[60] The principle established by the Treaty of Versailles, Arts 296–298, on 28 June 1919, was that the right to retain and liquidate all property of German nationals within the territories of the Allied Powers was reserved to the Allied Powers, while Germany was to compensate her own nationals whose property had been taken over by the Allied Powers. It was, in Keynes' words, "one of the most serious acts of political unwisdom for which our statesmen have ever been responsible", see J.M. Keynes, *The Economic Consequences of the Peace* (1919), 92.

[61] Although Innes CJ's judgment was to prove particularly influential, it may be helpful also to note Solomon JA's comment (*Overseas Trust*, above fn.56, 1926 AD 444 at 457) that:

> "[I]t is important, however, to bear in mind that these companies had gone into liquidation before the shares were acquired by the appellant company and that the accumulated profits had accumulated prior the acquisition. The companies in question had ceased to carry on business and were no longer employing capital in South-West Africa for the purpose of earning profits. If we apply the test laid down in *Dunn & Co*'s case, it seems clear that the capital employed to earn the sum of money in question was what was spent in the purchase of the shares, which carried with them the right to participate in the fund in the hands of the Custodian. The purchase of the shares took place in Cape Town, and that is where the capital was employed for the purpose of earning the profit."

In Solomon JA's view (*Overseas Trust*, above fn.56, 1926 AD 444 at 454), the sales of shares via a German broker were isolated transactions controlled throughout from Overseas Trust's Cape Town office and there was no proof that Overseas Trust carried on business in Germany or employed capital there, the brokers being merely agents executing instructions. Capital was, therefore, employed in the Union. The position "would have been different" if Overseas Trust had carried on part of its business in Germany.

> companies been going concerns engaged in mining operations in South-West Africa there would be much to be said for the view that the shareholders drew their dividends from the same source as those companies; and that the source was outside the Union where their business was being carried on and their capital employed. But that is not the position. The companies in question had ceased operations before the appellant acquired their shares, and those shares were merely instruments entitling the holder to certain monies which had been previously paid to, and were being held by, the custodian. The Appellant took over those instruments in order to obtain the money to which they related. And the resulting profit sprang neither from business nor service, but from the employment within the Union of the capital expended in the acquisition of the shares or instruments. That being so, it cannot be said to have been acquired from an extra-Union source."[62]

Watermeyer CJ then proceeded to comment as follows:

> "The statement by Menzies Murray which is quoted above by Innes, C.J.…bears a striking similarity to the statement in *Rydge Income Tax*…which is as follows:
>
> > 'The source of income may be said to be the business capital or service which is responsible for the earning of the income. If the capital or services be located in Australia then the particular income has been earned within the Commonwealth.'
>
> The statement in the judgment of INNES, C.J. that the word 'source' denotes 'origin' and not 'location' should be noticed. It means that the word 'source' in the Act does not denote the quarter from which the money is received but the originating cause of the receipt (i.e., the particular activity of the taxpayer which earns money)."[63]

There is, therefore, a thread that leads directly from Innes CJ's judgment in *Overseas Trust*[64] to Watermeyer CJ's judgment in *Lever Brothers*.[65] Apart from Ingram's *quasi ex cathedra* reflections in his textbook published in 1933,[66] there is little or no sign of South African tax law having adopted a "practical man"/"practical hard matter of fact" test.

The reason for a "practical man"/"practical hard matter of fact" test not being adopted emerges from a careful reading of both the majority and the minority judgments in *Lever Brothers*, which also serves to underline the difficulties with a "practical person"/"practical hard matter of fact" test.

Watermeyer CJ, who spoke for the majority, had this to say about how the "practical man" would approach the facts before the Court[67]:

> "Again, if Lord Atkin's suggestion be followed and the question be asked what would the practical man regard as the real source of the income, though I have some difficulty in differentiating the reasoning of the practical man from that of the theoretical lawyer for this purpose, I think the answer would probably be that the source of Levers' income was the

[62] *Overseas Trust*, above fn.56, 1926 AD 444 at 453–454.
[63] *Lever Brothers*, above fn.22, 14 SATC 1; [1946] AD 441.
[64] *Overseas Trust*, above fn.56, 1926 AD 444.
[65] *Lever Brothers*, above fn.22, 14 SATC 1; [1946] AD 441.
[66] Ingram, above fn.51.
[67] *Lever Brothers*, above fn.22, 14 SATC 1 at 15–16.

> operations of the American Companies which produced the money out of which the interest was paid. I cannot think that the practical man could ever come to the conclusion that the money came from a source in South Africa."

To which Schreiner JA, who gave a dissenting judgment, had this to say in reply[68]:

> "In my view the source of Levers' income, so far as it consisted of the interest, was the debt i.e. the *aes alienum* or money of Levers in the possession of *Overseas Holdings*….No doubt the location of an incorporeal in space by a rule of law carries a flavour of artificiality but even the practical business man of the cases would realise, when the matter was explained to him, that for certain purposes it is unavoidable.…I have referred to the practical business man whose hypothetical views on these matters are said to be entitled to great weight. And it is suggested that the view that interest on a loan debt has its source in the place where the debt is situated is artificial and based on legal fiction. No doubt excessive subtlety is particularly to be avoided in the solution of those income tax problems that are closely related to the conduct of affairs in trade and industry. But I am disposed to think that a practical business man would be surprised if he were informed that the source of interest on a long term loan was the contract, made possibly decades ago, and not the loan debt itself. And if he were told that the Statute made it necessary to fix the local situation of the interest bearing debt, it is not unlikely that, while expressing a tentative layman's view in favour of placing it at the residence of the debtor, he would indicate that the obvious thing to do would be to ask a lawyer. But, after all, we are concerned in this case not with ordinary everyday business transactions but with a series of complicated legal documents of an unusual character, designed to create and transfer legal rights in the light of international developments and not, it may be supposed, without some regard to the revenue laws of the countries concerned. What factors induced Levers to select the soil of South Africa as the most favourable one into which to transplant the fruitful tree whose existence in Holland was threatened we do not know, but the precise effect of the operation does not appear to me to be a matter on which the opinion of the ordinary practical business man would provide much assistance."

In other words, two Judges who reached opposing conclusions on the question before the Court in *Lever Brothers* both sought to demonstrate how a "practical man" would have agreed with each of them, and both found the exercise futile. And, as a result, South African tax law embarked upon a different path (on which it was to remain until earlier this century, as discussed further below) by means of which

> "the source of receipts, received as income, is not the quarter whence they come, but the originating cause of their being received as income and that this originating cause is the work which the taxpayer does to earn them, the *quid pro quo* which he gives in return for which he receives them".[69]

[68] *Lever Brothers*, above fn.22, 14 SATC 1 at 20–22.
[69] *Lever Brothers*, above fn.22, 14 SATC 1 at 8–9.

Instead of following a "practical man" up-valley and down-dale in search of a "practical hard matter of fact", South African tax law therefore took a different path to identify the source of an interest payment. The notion was developed that the source of income for South African income tax purposes should be determined by reference to "the main, the real, the dominant, the substantial source" of income.[70] Ultimately, *Lever Brothers* was, at least in part, overruled by *First National Bank of South Africa Ltd v Commissioner for the South African Revenue Service*[71] where it was held that interest arose from the breadth of a bank's business activities in South Africa notwithstanding that loans were made in a foreign currency to borrowers outside South Africa. However, uncertainty associated with the South African authorities relating to the "true" source of interest became, in an effort to provide certainty (and contain avoidance), overlaid by further statutory deeming rules now contained in section 9 of the South African Income Tax Act 1962.

Those rules were amended on a number of occasions and, prior to 1 January 2012, section 9(6)–(7) of the Income Tax Act 1962 treated interest derived from the utilisation or application in South Africa by any person of any funds or credit obtained in terms of an interest bearing arrangement as having a source in South Africa. Successive amendments to those statutory deeming rules proved unsatisfactory and, as South Africa increasingly sought international investment from the mid-1990s, a residence basis of taxation replaced the source rules for recipients of income who resided in South Africa (with the deemed source rules being retained only in respect of income arising to non-residents). This position too was unsatisfactory and the Taxation Laws Amendment Act 24 of 2011 was introduced in recognition of the fact that the source rules gave "rise to uncertainty, thereby imposing additional costs in respect of cross-border activities with little or no benefit for the *fiscus*".[72] By virtue of the 2011 reforms the South African Treasury decided that[73]:

> "The source of interest will largely be determined using implicit OECD principles. The determination of source of interest will now be based on a two-part test, namely (i) the residence of the debtor paying/incurring the interest, or (ii) the place in which the loan funds are utilised or applied. Therefore, interest will be sourced in South Africa if (i) paid by a South African resident, or (ii) if the interest is derived from use or application in South Africa (e.g. from a South African permanent establishment). The proposal removes any current law focus on the credit provider."

Section 9(2) of the Income Tax 1962, as amended by the 2011 Act, provides that:

> "An amount is received by or accrues to a person from a source within the Republic if that amount—…
> (b) constitutes interest…where that interest—

[70] *CIR v Black* (1957) 3 SA 536 (A) at 543 and also *Essential Sterolyn Products (Pty) Ltd v CIR* (1993) 4 SA 859 (A) and the Botswana case of *Transvaal*, above fn.55, BLR 1964–1967 207 (CA).
[71] *First National Bank of South Africa Ltd v Commissioner for the South African Revenue Service* 2002 (3) SA 375 (SCA).
[72] Republic of South Africa, *National Treasury, Explanatory Memorandum on the Taxation Laws Amendment Bill, 2011* (27 January 2012), para.4.2 II, p.97.
[73] Republic of South Africa, above fn.72, para.4.2 III, p.98.

(i) is attributable to an amount incurred by a person that is a resident, unless the interest is attributable to a permanent establishment which is situated outside the Republic; or

(ii) is received or accrues in respect of the utilisation or application in the Republic by any person of any funds or credit obtained in terms of any form of interest-bearing arrangement."

Bearing in mind that South Africa disclaimed the "practical man's" legacy with respect to interest from 1 January 2012 (when the 2011 Act came into force) because the unattractiveness of that legacy had become all too apparent after the shackles of Apartheid had been removed, it may seem surprising (and, indeed, a retrograde step) that a "practical person" should now be resurrected to serve UK tax law.

Second stone: the South African "deemed source" rules create a very different legislative context to that provided by UK legislation relating to the source of interest

In light of the repeated judicial warnings (including by Lord Atkin himself and also by Arden LJ in *Ardmore CA*[74]) about the dangers of uncritically following jurisprudence relating to a different statutory context in seeking to settle questions of source, the fact that Ingram CJ was writing about the South African Income Tax Act of 1925 which introduced "deemed" source rules should set alarm bells ringing at any suggestion that the "practical" approach Ingram CJ discussed in relation to South African tax law (where the taxation of profit derived from mining activities had a pre-eminent importance) should have any useful application when construing UK legislation concerned (more narrowly) with the source of interest.

Section 9(1)[75] of the South African Income Tax Act of 1925 stated as follows:

"An amount shall be deemed to have accrued to any person from a source within the Union, whenever it has been received by or has accrued to or in favour of such person by virtue of:

(a) any contract made by such a person within the Union for the sale of goods, whether such goods have been delivered or are to be delivered in or out of the Union;

(b) any service rendered or work or labour done by such person in carrying on in the Union of any trade, whether the payment for such service or work or labour is made or is to be made by a person resident in or out of the Union and wherever payment for such services or work or labour is made or is to be made;

(c) any services rendered by such person to or work or labour by such person for or on behalf of the Government of the Union or any provincial or local authority within the Union, notwithstanding that such services are rendered or such work or labour is done outside the Union: Provided that such services are rendered or such work or labour is done in accordance with a contract of employment entered into with the Government of the Union or a provincial or local authority within the Union;

[74] *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438.

[75] South African Income Tax Act 1925 s.9(2) and (3) addressed, respectively, income of a married woman (deemed to be that of her husband) and the income of a minor child (other than bona fide remuneration for services rendered!).

(d) any pension or annuity granted to such person by any person residing in or carrying on business in the Union or by the Government or Railways and Harbours Administration of the Union or any provincial or other local authority therein, wheresoever payment of such pension or annuity is made and wheresoever the funds from which payment is made are situated: Provided that no pension or annuity shall be deemed to be derived from a source within the Union if the service or employment in respect of which it is granted was performed wholly outside the Union."

This is, it should be clear, a long way indeed from the statutory language in section 368 of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA) which refers simply to "interest arising in the United Kingdom…from a source in the United Kingdom" (and, indeed, far from the UK tax statute defining what, when *Rhodesia Metals*[76] came before Lord Atkin, fell within Case III of Schedule D[77]).

Indeed, even within a South African context, a considerable amount of confusion has been caused by questions relating to the extent (if at all) that source should be determined differently in relation to income arising from capital as opposed to from services. That distinction, which was implicit in Innes CJ's decision in *Overseas Trust*,[78] was somewhat blurred by the introduction of statutory source deeming rules in 1925. This is how Ingram described the position in 1933[79]:

> "A well-known classification of income consists in a division between income, the product of the employment of capital, and income which springs from the reward of, labour and services rendered[80]. This division of income is to a certain extent followed by the Act in its provisions relating to source in particular cases. As to any general definition of source the Act is silent. Nor does it lay down any particular guide in the case of income falling under the former head of classification, viz., income derived from the employment of capital.

[76] *Rhodesia Metals*, above fn.21, [1940] AC 774.

[77] The First Schedule to the UK's Income Tax Act 1918 delineated Schedule D Case III as follows (at para.(1)):

"(a) any interest of money, whether yearly or otherwise, or any annuity, or other annual payment, whether such payment is payable within or out of the United Kingdom, either as a charge on any property of the person paying the same by virtue of any deed or will or otherwise, or as a reservation thereout, or as a personal debt or obligation by virtue of any contract, or whether the same is received and payable half-yearly or at any shorter or more distant periods;

(b) all discounts;

(c) profits on securities bearing interest payable out of the public revenue other than such as are charged under Schedule C;

(d) interest, annuities, dividends and shares of annuities payable out of any public revenue where the half-yearly payments in respect thereof do not exceed fifty shillings and are not chargeable under Schedule C;

(e) interest paid or credited in full without deduction of tax by any savings bank to any depositor;

(f) interest on any Exchequer bonds issued under the authority of the Treasury during the continuance of the present war and a period of six months thereafter and on any securities issued under the War Loan Acts, 1914-1917, or any Act amending those Acts, in cases where such interest is paid without deduction of tax."

[78] *Overseas Trust*, above fn.56, 1926 AD 444.

[79] Ingram, above fn.51, 65.

[80] Ingram's footnote: "See *Boosen's case* (1918 A.D. at p.594), and *cf. Hamilton v Commissioner for Inland Revenue* (1921 A.D. at p.6)."

> But in the case of income falling with the latter head, viz., income derived from services rendered, pensions and the like, and also in the somewhat special case of income derived from the sale of goods, it provides by section 9, certain specific attributes the presence of which affects the income to which they relate with a Union source."

The existence, or otherwise, of that distinction would continue to cause difficulty. In *Income Tax Case No.738*,[81] for example, the Court took the position (wrongly, it has subsequently been pointed out, albeit at the time to the evident relief of Dowling J[82]) that *Lever Brothers* did not apply as a general proposition to personal service income. Moreover, the inability of the "originating cause" formulation adopted in *Lever Brothers* to address a composite payment made for services performed in different locations led to a refined search for a "dominant" cause; as Schriener JA put it in a judgment given in the Botswana Court of Appeal "it has been held that the dominant (or main or substantial or real or basic) cause of the accrual of income must be sought".[83] Consequently, South Africa, which seemingly started with a division between the source of income arising from capital and personal services, supplemented that division with statutory deemed source rules, before settling on an "originating cause" approach, which was then further refined to identify a "dominant", etc. cause. That South African experience feels like a very long way from the statutory environment in the UK relating to the taxation of interest (to which, amongst other things, the complicating and obscuring effects of statutory source deeming rules are altogether foreign).

Third stone: the "practical hard matter of fact" approach derives from Australian cases related, not to the source of interest, but to the source of mining profits

As the footnotes to Ingram's work (reproduced above) make quite clear, the "practical hard matter of fact" test derived directly from Australian case law and, in particular, a commentary on Australian tax law written by Norman B. Rydge.[84]

Rydge was primarily concerned with, and drew his material from, two judgments of the Australian courts (which, like the South African courts, were much concerned with profit arising in one form or another from mining).

[81] *Income Tax Case No.738* (1951) 18 SATC 213 (T).

[82] For analysis of the decision, see Hattingh, above fn.50, 666.

Dowling J observed (*Income Tax Case No.738*, above fn.81, (1951) 18 SATC 213 (T)) that a "more difficult question" might have arisen if he had sought to apply the "somewhat difficult learning" propounded by Watermeyer CJ in *Lever Brothers*, above fn.22, 14 SATC 1; [1946] AD 441 in relation to the source of income.

[83] *Transvaal*, above fn.55, BLR 1964–1967 207 (CA) at 219. Compare Roper J who understood the identification of a dominant cause as merely part of the application of the "practical man" test (at 216–217): "But in the search for the dominant factor, or the real and basic cause, added value is not decisive. It is only one of the circumstances which the practical man must take into consideration, and the question of its weight may depend upon degree."

[84] Norman Bede Rydge ACPA AICA (born 1900) described himself, in 1923, as a public accountant and tax consultant. Subsequently establishing Rydge's *Business Journal* (1928), he became a successful stock exchange investor with significant hotel and cinema interests (including from 1945, a close relationship with Arthur J. Rank and, hence, the Rank organisation); he was knighted 1966 and died in 1980. His tax background, perhaps, helps explain the practice adopted by his investment vehicle, Carlton Investments, of paying dividends only in the form of bonus share issues which, in the absence of capital gains tax, could be disposed of without incurring a tax liability. See J. Perkins, "Rydge, Sir Norman Bede (1900–1980)" in National Centre of Biography, Australian National University, *Australian Dictionary of Biography* (published first in hardcopy 2002), available at: *http://adb.anu.edu.au/biography/rydge-sir-norman-bede-11596/text20703* [Accessed 19 February 2020].

The first such judgment, in *Nathan v Federal Commissioner of Taxation* (*Nathan*)[85] concerned the application of the Australian Income Tax Assessment Act 1915–16 (AITA 1915–16) and the Income Tax Act 1915. Section 4 AITA 1915–16, in order to apply differential rates of tax to different categories of income, divided "income" into two classes: 1. "income derived from personal exertion"; and 2. "income derived from property". Section 2 AITA 1915–16 provided that that Act was to be read as one with the Income Tax Act 1915 and section 3 of the Income Tax Act 1915 defined "Income from personal exertion" and "income derived by any person from personal exertion" as meaning "income derived in Australia" consisting of earnings and a number of other matters. "Income from property" was in turn defined as meaning "income derived in Australia and not derived from personal exertion". Consequently, the legislation envisaged "income" being divided into two categories, each of which was mutually exclusive and exhaustive. Section 10 of the Income Tax Act 1915 then provided that income tax was to be levied and paid upon the taxable income "derived directly or indirectly by every taxpayer from sources within Australia". Taking the scheme of the legislation as a whole, and drawing on a Privy Council decision[86] on a New Zealand taxing statute,[87] Isaacs J was content that for these purposes taxable income could be directly or indirectly derived from Australia and that income not so derived was not subject to tax in Australia.

Nathan was concerned with the taxability of income received by a shareholder, who was resident in New South Wales, from S. Hoffnung & Co Ltd, the Bank of Australasia and Farmer & Co Ltd, each of which were incorporated, had a registered office in, and were centrally managed and controlled, in England. The three companies each made profits from activities carried on in Australia and also from activities carried on in England and elsewhere. The question for the Court was whether the dividends that arose constituted "income derived in Australia" and, thereby, had an Australian source. In relation to this, Issacs J had the following to say:

> "But still the question remains: Is the 'source' of the appellant's dividends 'within Australia'?….
>
> The Legislature in using the word 'source' meant, not a legal concept, but something which a practical man would regard as a real source of income. Legal concepts must, of course enter into the question when we have to consider to whom a given source belongs. But the ascertainment of the actual source of income is a practical, hard matter of fact."[88]

Notwithstanding the subtle distortion and transformation of Isaacs J's somewhat specific reference to the "The Legislature" into Ingram's more expansive formulation of a general definition of source, the origin of Ingram's understanding of the meaning of source is readily apparent.

[85] *Nathan v Federal Commissioner of Taxation* [1918] HCA 45; 25 CLR 183.
[86] *Lovell & Christmas Ltd v Commissioner of Taxes* [1907] NZPC 4; [1907] UKPC 57; [1908] AC 46 at 52 where the House of Lord's decision in *Grainger & Son v Gough (Surveyor of Taxes)* (*Grainger*) [1896] AC 325 was applied. In *Grainger* the House of Lords decided that Louis Roederer, who was a champagne merchant residing and carrying on business in France during the years 1884, 1885, and 1886 did not exercise his trade in the UK within the meaning of Schedule D of the Income Tax Act of 1853.
[87] Land and Income Assessment Act 1900 (64 VICT 1900 No 49) s.52.
[88] *Nathan*, above fn.85, 1918 25 CLR 183 at 189–190.

Before we pass on to consider the second case cited by Rydge (and Ingram), an additional reason for caution before applying the Australian jurisprudence to assist in determining the source of interest for UK tax purposes might be thought to lie in section 10 AITA 1915–16 which provided that "where a company derives income from a source in Australia and from a source outside Australia a taxpayer shall only be taxable on so much of the dividend as bears to the whole dividend the same proportion that the profits derived by the company from a source in Australia bears to the total profits of the company". As Isaacs J himself commented those words "seem to us to indicate the intent of the Legislature in a most unmistakable manner".[89] It would be a somewhat perverse approach to the Australian legislation to ignore those words and, irrespective of Isaacs J's musing on the meaning of "source", the literal force of those words would strongly suggest that Isaacs J's decision that the dividends had an Australian source could have been reached by means of a straightforward process of statutory construction. The significance of a streaming concept, in the context of a consideration of the UK Court of Appeal's decision in *Ardmore CA* is that there is not, and never has been, any equivalent statutory "streaming" provision in the UK relating to identifying the source of interest.[90]

The second case referred to by Rydge (and Ingram) is that of *Adelong Gold Estates No Liability v The Commissioner of Taxation* (*Adelong*).[91] The context for *Adelong* was a prohibition imposed on miners in 1915 from exporting gold from New South Wales and the imposition of a requirement to sell their gold to the Imperial mint. As the gold price soared (and extraction costs increased) during the First World War this prohibition put Australian miners at a significant international disadvantage and, as a result, an association comprised of gold miners was permitted to exchange gold mined by its members for sovereigns produced by the mint; those sovereigns were then exported and sold abroad. The question for the Court was whether profits arising from the sale of the sovereigns was derived from a source in Australia for the purposes of section 4 of the Income Tax Management Act 1912. In a passage that would find its way into Ingram's commentary, via Rydge's commentary, Gordon J observed that the "question must be decided as a practical matter of fact - taking the substance of the transaction and disregarding the form" and held that "the Court must look to the actual result and disregard the means by which that result was obtained".[92]

[89] *Nathan*, above fn.85, 1918 25 CLR 183 at 191.

[90] For an overview of the Australian and New Zealand case law which developed in connection with the need to distinguish between income with a source within the jurisdiction that was subject to tax and income sourced elsewhere which was outside the charge to income tax, and also the contribution of that jurisprudence to Hong Kong tax law, see M. Littlewood, "An Australasian Contribution to Hong Kong Tax Law" (2000) 10 Revenue L.J. 41.

With regard to South African law, Hattingh notes that: "Shreiner's dominant causality approach to the source of income from integrated business transactions caused a divergence to arise in South African jurisprudence because this approach did not admit apportionment of income derived from such highly integrated business transactions. On the other hand, courts clearly allowed apportionment of income derived from personal service income to several sources. These legal positions have ever since co-existed. No South African court has decided that Shreiner's approach to income derived from integrated business transactions that prevailed in 1957 in *CIR v Black*, did away with the law that personal service income could be time-apportioned to several sources." See Hattingh, above fn.50, 669.

[91] *Adelong Gold Estates No Liability v The Commissioner of Taxation* (1922) 22 SR (NSW) 197.

[92] *Adelong*, above fn.91, (1922) 22 SR (NSW) 197 at 203.

The key phrases adopted by Lord Atkin in *Rhodesia Metals*,[93] and in turn by Arden LJ in *Ardmore CA*,[94] can therefore be traced directly back to two Australian cases, neither of which related to interest, and each of which originated in a very different statutory context to that which has existed and exists in the UK.

The nature of that statutory context in Australia can be appreciated by looking at the Australian legislation with reference to which Rydge was writing in 1923. Section 13(1) of the Australian Income Tax Assessment Act 1923 stated:

> "Subject to the provisions of this Act, income tax shall be levied and paid for each financial year upon the taxable income derived directly or indirectly by every taxpayer from sources within Australia during the period of twelve months ending on the thirtieth day of June preceding the financial year for which the tax is payable."

This statute imposed Australian income tax where income was "directly or indirectly" derived from "sources" (note the use of "indirectly" and the plural "sources") in Australia. This formulation is clearly different from the language used in section 368 ITTOIA with which the Court of Appeal was concerned in *Ardmore CA*.[95]

Furthermore, not only was (and is) the Australian statutory context different from the legislative context (then or now) in the UK, but it is evident that Rydge was well aware of the difficulties that could arise if the differences between Australian and UK legislation were not treated with due respect. Indeed, Rydge complained that[96]:

> "Unfortunately, it would seem as though the exact legal position has been somewhat clouded by the application of English decisions which do not entirely apply to our Federal enactment."

The Australian courts have continued to wrestle with the difficulties associated with determining whether income has a source in Australia. Recently, in *Commissioner of Taxation v Resource Capital Fund IV LP* (*RCF IV*)[97] the Federal Court of Australia has expressed the test for whether income has an Australian source for Australian tax purposes as being a search for whether the "proximate source" of income is in Australia.[98]

[93] *Rhodesia Metals*, above fn.21, [1940] AC 774.
[94] *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438.
[95] *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438.
[96] N.B. Rydge, *Commonwealth Income Tax Acts, 1922-1923 and Regulations Thereunder: Together with a full explanation of each section and a statement of Departmental Practice and the Decisions of the Imperial, Australian and New Zealand Courts* (Sydney, Melbourne and Brisbane: The Law Book Co. of Australasia Ltd, 1923), 44.
[97] *Commissioner of Taxation v Resource Capital Fund IV LP* [2019] FCAFC 51; 266 FCR 1; 135 ACSR 486.
[98] The Income Tax Assessment Act 1997 s.995-1 provides that "ordinary income or statutory income has an Australian source if, and only if, it is derived from a source in Australia for the purposes of the Income Tax Assessment Act 1936".

Australian domestic law is not, however, necessarily determinative as to whether income has an Australian source. In *Satyam Computer Services Ltd v Commissioner for Taxation* (2018) 21 ITLR 274; [2018] FCAFC 172 the Federal Court of Australia held that the combined effect of a deemed source rule in the Australia/India double taxation treaty (Agreement between the Government of Australia and the Government of the Republic of India for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income [1991] ATS 49 (entered into force on 30 December 1991)) Art.23 and the Australian International Tax Agreements Act 1953 s.4(2) was to impose Australian tax on a royalty in circumstances in which, were it not for the treaty, the royalty would not have been within the charge to Australian tax (i.e. as imposed solely by Australian domestic law).

In *RCF IV* two corporate limited partnerships had realised a gain from the sale of their shares in a company (Talison Lithium Ltd (Talison)), the value of which was attributable to a lithium mine[99] in Greenbushes, south western Australia. Counsel for the taxpayer argued that: 1. all decisions and negotiations for the investment in Talison were made by the Investment Committee of the general partner outside Australia; 2. monitoring of the investment was conducted by the Investment Committee of the general partner outside Australia; 3. all decisions and negotiations regarding the disposal of the investment were made by the Investment Committee of the general partner outside Australia; 4. the limited partners could not and did not take any part in the management of the partnership and were passive investors; 5. before making important decisions, the Investment Committee of the general partner took advice from the management company, RCF Management LLC, outside of Australia; 6. the shares which were disposed of were listed and were freely tradable on the Toronto Stock Exchange; and 7. the consideration for the disposal of shares was paid on behalf of Tianqi, a Chinese company, and was payable and received outside Australia and in Canadian dollars. However, on the other side of the coin: the strategy adopted comprised not merely the passive holding of shares, but also involved an acquisition of shares and then a restructure and management of the underlying business in order to secure a better profit from a future sale. This was achieved with the help of RCF Management Pty Ltd which had an office in Australia, active employees in Australia (for example, frequently participating in investment committee meetings) and which provided two directors who sat on Talison's Board of Directors.[100]

The Federal Court acknowledged Stephen J's observation in *Esquire Nominees Ltd v Federal Commissioner of Taxation*[101] that:

> "To say that questions of source depend upon practical matters of fact will not necessarily assist in determining which of a range of possible meanings of source is meant, but context should provide a solution.…the source referred to is that from which income is produced by the taxpayer's own acts of derivation or ownership. All this suggests that a quite proximate source is being referred to."[102]

And decided that:

> "A proximate origin of the profits here was thus the scheme of arrangement and the location of that arrangement was unquestionably in Australia. The *locus* of the scheme is analogous to the place where the contract was made in Tariff Reinsurances, and to the making of the contract in New South Wales considered in *Premier Automatic Ticket Issuers Ltd v Federal Commissioner of Taxation* [1933] HCA 51; (1933) 50 CLR 268. In *Premier Automatic*, income payable under a contract had a source in Australia because that was where the contract had been made. As Rich J. said at 286:

[99] Although irrelevant for tax purposes, it is interesting to note that this mine is adjacent to the largest lithium mine in the world, which is responsible for 40% of the global production of lithium.
[100] The general partner of RCF IV had entered into an agreement with RCF Management LLC for the management of the operation and investments of each partnership through an investment committee. RCF Management LLC had, in turn, entered into an agreement with RCF Management Pty Ltd pursuant to which administration and management services were supplied.
[101] *Esquire Nominees Ltd v Federal Commissioner of Taxation* [1973] HCA 67; (1973) 129 CLR 177.
[102] *RCF IV*, above fn.97, [2019] FCAFC 51 at [61].

> 'The profits were derived by the taxpayer from its enforceable right, conferred by the agreement in the events which happened, to a sum amounting to ten per cent of the purchase money. The source of this right was the making of the agreement which took place in New South Wales. For these reasons I think that as a matter of law the profits arose from a source in New South Wales.'
>
> Here, each respondent's 'enforceable right' to the proceeds of the sale of the interests and shares in Talison Lithium arose from the scheme of arrangement. That arrangement took place in Australia, and accordingly, because the scheme was the 'proximate' origin of the profits earned, and because of the other connections with Australia summarised by the primary judge…, including the location of the mine in Western Australia, those profits had a source in Australia. At the very least, it was open to his Honour so to conclude."[103]

So, as *RCF IV* demonstrates, the Australian experience (like that in South Africa) is one in which reliance on a "practical hard matter of fact" has fallen far short.

The observation all this invites in relation to the Court of Appeal's decision in *Ardmore CA*[104] is that, in adopting terminology approved by Lord Atkin, the Court of Appeal seems inadvertently to have fallen into the error that Arden LJ (and before her, Lord Atkin himself in *Rhodesia Metals*[105]) warned should be avoided, namely that of applying foreign authorities in a UK context. In a sense, to the extent that *Ardmore CA*[106] encouraged the source of an interest payment to be approached as a "practical hard matter of fact", the effect of a decision made in England[107] may be said to have allowed Australian (and/or South African) law originally developed nearly 100 years ago to identify the source of profits arising primarily from mining[108] to have "clouded" the determination of the source of interest for the purposes of UK income tax.

Where does this leave UK law in the wake of the Court of Appeal's judgment in *Ardmore CA*?

On a purely practical level, the difficulties in predicting how a "practical person" should divine source as a "practical hard matter of fact" can be illustrated by testing differing fact patterns

[103] *RCF IV*, above fn.97, [2019] FCAFC 51 at [64]–[65].
[104] *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438.
[105] *Rhodesia Metals*, above fn.21, [1940] AC 774.
[106] *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438.
[107] Perhaps, in preference to "English judges", because although Lord Atkin was brought up in Wales from the age of three prior to his birth (in 1867) his parents had both emigrated to Australia where James Atkin (as he then was) was born.
[108] Lord Atkin acknowledged "doubt" with respect to the emphasis placed by Innes CJ in *Overseas Trust*, above fn.56, 1926 AD 444 on the "productive employment of capital" and also reflected the (entirely understandable, given the question before the Privy Council in *Rhodesia Metals*) focus upon a business (e.g. rather than a specific right to an interest payment) (*Rhodesia Metals*, above fn.21, [1940] AC 774 at 789):

> "A doubt may be expressed whether the words borrowed by Stratford, C. J., from Innes, C. J., in the *Overseas Trust* Case (supra) 'productive employment of capital' really help to define the situation. Is capital productively employed in the place where it purchases stock which is profitably sold elsewhere, or in the place where the stock which now represents the capital is sold, or for purposes of the test must both purchases and sales occur in the same place; or is it sufficient that the place of the direction of the employment of the capital in purchasing or selling should denote where the capital is productively employed? Perhaps in other words it may be said, does it mean more than carrying on business in a place?"

against Arden LJ's explanation (cited above[109]) as to why the facts in *Ardmore CA*[110] were consistent with the interest paid by Ardmore CL to the trustees in Gibraltar having a UK source. A taxpayer (or professional advisor) seeking to work out whether, in a slightly differently scenario, interest has a UK source is left to wonder what difference (if any) it would have made if the facts had fallen out a little differently? For example: what sort of activity on a lender's part would constitute sufficient activity to carry materially more weight; would it have made a material difference if collateral had been held in Gibraltar to secure the borrower's obligation to pay interest; would it have altered the position if there had been a default? If the "immediate search" is for the source of the interest (rather than, indirectly, for the source of the loan) at what point (if at all) is it legitimate to consider the source of the loan?

A focus on a "practical hard matter of fact" may be said to come very close to creating what is akin to law without content. Although there should be no difficulty, in principle, with factors being "weighed", in the absence of guidance beyond an appeal to what a "practical person" would make of a particular fact pattern, the taxpayer contemplating making a payment may have little option but to "guess" and keep his, her, or its fingers tightly crossed while waiting until HMRC are out of time to issue a discovery assessment (not least because HMRC have for many years refused to, and are understood to continue to refuse to, issue any non-statutory clearances with respect to source). Although there is no suggestion in *Ardmore CA* that an increase in uncertainty was something the Court of Appeal sought to achieve (even if HMRC may have perceived such a result, or at the very least the maintenance of doubt, as desirable), it is hard to see how, short of applying to the FTT for a finding of fact, the taxpayer is to know how to approach the weighing exercise.

Professor Judith Freedman, albeit writing in a slightly different context, has drawn attention to the dangers of taxing by reference to a business meaning of words (and, if we are to heed a "practical person" on a "practical hard matter of fact", then such a person would presumably take a business person's approach)[111]:

> "We might think that we should tax on a basis approaching something as near to reality as possible but, as Lord Hoffmann has pointed out, there are dangers in talking about reality in this context.[112] As he states, 'Something may be real for one purpose but not for another.'…The tax system is not founded purely on *economic reality*, even if we were to know what that was. It has to be about *legal reality*…because that is the only practical and operable way to construct a tax system. What we decide to tax may be something quite artificial; income, for example, is an artificial construct. In the business context it bears some relation to the accounting concept of profit but how real is that? Accounting profit is based on a set of standards designed to give a true and fair view of the profits, but it is one view, seen from one perspective: just one other version of 'reality'.…
>
> Legal reality may often be trying to reflect some sort of commercial or economic reality but it will not achieve this in every case. This does not mean that the legal distinctions

[109] See fn.43 of this article and accompanying text.
[110] *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438.
[111] J. Freedman, "Defining Taxpayer Responsibility: In Support of a General Anti-Avoidance Principle" [2004] BTR 332, 343.
[112] Freedman's footnote: "*Westmoreland v MacNiven* [[2001] STC 237] at p.251."

> created are unreasonable…since the entire system is based on legal distinctions and needs to be in order to operate."

The reliance, advocated in *Ardmore CA*, on identifying source as a "practical hard matter of fact" suffers from difficulties that are in many ways not dissimilar from those associated with the distinction famously drawn by Lord Hoffmann in *MacNiven (Inspector of Taxes) v Westmoreland Investments Ltd* (*MacNiven*) where he said[113]:

> "Taxing statutes often refer to purely legal concepts. They use expressions of which a commercial man, asked what they meant, would say 'You had better ask a lawyer'."

Turning again to Professor Freedman, writing this time in light of the House of Lord's landmark decisions in *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* (*BMBF*)[114] and *IRC v Scottish Provident Institution* (*Scottish Provident*)[115] (and before the introduction of the General Anti-Abuse Rule (GAAR)),[116] the importance of the law being clear even if it is not always certain is emphasised:

> "It is questionable whether their Lordships have achieved their expressed aim of clarification in *BMBF* and in the accompanying opinion in *Scottish Provident*. Despite their intention of producing *clarity* it should be noted that their Lordships do not purport to be aiming at *certainty*. For obvious reasons, *certainty*, in the sense of a precise road map for those designing tax avoidance schemes, would not be desirable.[Footnote omitted] What is needed is *clarity* in the sense of knowing the principles to be applied and their constitutional source and authority."

It is suggested that the central problem with the approach taken by the Court of Appeal in *Ardmore CA*,[117] when excised from the facts of *Ardmore* and projected onto other real-world scenarios, is that clarity seems a more distant goal. If every factor is relevant, then absent some means of attaching weight to those factors or an objectively rationalised methodology, the application of the multifactorial test seems to be in danger of being reduced to the outcome of a particular process (carried on by the relevant FTT).

Where next?

The dangers of the approach signposted by the Court of Appeal's judgment in *Ardmore CA*[118] should now be apparent: a "practical person", identifying a "practical hard matter of fact", has never made a constructive contribution to South African tax law relating to source; the alternative route preferred by the South African courts from *Overseas Trust*[119] (via *Lever Brothers*[120]) until

[113] *MacNiven (Inspector of Taxes) v Westmoreland Investments Ltd* [2001] UKHL 6 at [58].
[114] *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* [2004] UKHL 51.
[115] *IRC v Scottish Provident Institution* [2004] UKHL 52.
[116] See J. Freedman, "Interpreting Tax Statutes: Tax Avoidance and the Intention of Parliament" (2007) 123 *Law Quarterly Review* 53, 62–63.
[117] *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438.
[118] *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438.
[119] *Overseas Trust*, above fn.56, 1926 AD 444.
[120] *Lever Brothers*, above fn.22, 14 SATC 1; [1946] AD 441.

legislative intervention in 2011 proved unfit for purpose; and the Australian Federal Court has recently found it necessary to look to a "proximate cause" test to address perceived shortcomings in the "practical hard matter of fact" test.

What, then, is the alternative? It is suggested that two alternative approaches may constructively be considered, each of which is examined below.

Statutory reform

One approach which could provide greater clarity would be to revisit a proposal floated by the Inland Revenue in a 2003 consultative document, *Income tax: Meaning of UK Source for Payments of Interest and Royalties* (the Consultation Document)[121] which raised the possibility of the introduction of a statutory definition of a UK source of interest. The Consultation Document noted[122]:

> "The current tests…are unclear and cause confusion. The statutory rules date back a long way and do not take account of modern financial practice. They have been subject to judicial interpretation, which has not always been easy to apply in practice."

At that time, the proposal was to introduce a general definition of the source of interest in line with that which applies for the purposes of the Council Directive on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States (the Interest and Royalties Directive), namely the residence of the payer or of the branch of the payer making the payment.[123] When the time came to introduce the Finance Bill 2004 this proposal failed to make the cut. However, the world has moved on since then.[124] As noted above, South Africa has adopted a statutory definition of source drawing upon OECD principles and, given the Government's enthusiasm for the BEPS Project evidenced by a host of measures from the hybrid mismatch rules to the amendment made by the Finance Act 2019 to the definition of "permanent establishment",[125] it would seem consistent with an openness to adopting OECD principles to adopt an OECD blessed statutory definition of source. Moreover,

[121] Inland Revenue, *Income tax: Meaning of UK Source for Payments of Interest and Royalties* (Inland Revenue, 10 December 2003).

[122] Consultation Document, above fn.121, para.1.1.

[123] Consultation Document, above fn.121, paras 4.1 and 5.1. Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States [2003] OJ L157/49 Art.1(2) provides that a payment made by a company or permanent establishment resident in a Member State is deemed to arise in that state.

[124] Albeit, not always helpfully. The approach taken by the European Court of Justice in *N Luxembourg 1 and others v Skatteministeriet* (Joined Cases C-115/16, C-118/16, C-119/16 and C-299/16) EU:C:2019:134 may be thought to have muddied the water too much for the Interest and Royalties Directive, above fn.123, at least as construed by the European Court of Justice in those conjoined cases, to serve as a model for UK domestic legislation.

[125] FA 2019 s.21. HM Treasury, *Finance (No. 3) Bill Explanatory Notes* (7 November 2018), 86, para.12, states: "This clause is an outcome of the OECD and G20 programme to tackle the erosion of the tax base by multinationals. It deals with their avoidance of permanent establishment by the splitting up of activities between locations or between related parties to take advantage of the exemption for preparatory or auxiliary-type activities. It makes effective the same change to the UK's tax treaties which the UK has adopted through the Multilateral Instrument and which took effect on 1 October 2018." For further evidence of the UK Government's enthusiasm for the OECD's BEPS Project, published just before this article went to press, see HM Government, *The Future Relationship with the EU: The UK's Approach to Negotiations* (CP211, 27 February 2020), 21 at para.79.

the development since 2003 of a more muscular approach to statutory construction heralded by the House of Lords judgment in *BMBF*[126] and the introduction of a GAAR ought to provide HMRC with considerable reassurance that the scope for abuse of a statutory definition should be minimal.

Guidance from the courts

Given the amount of ink spilt over the years attempting to read the runes in Lord Hailsham's judgment in the *National Bank of Greece HL* case,[127] and for lack of a better starting point, the nub of his judgment, it is suggested, lies in the following short passage:

> "In my view, the bond itself is a foreign document, and the *obligations to pay principal and interest to which the bond gives rise were obligations whose source is to be found in this document*."[128] (Emphasis added.)

This approach starts, therefore, with the obligation itself and leads to the document (and, presumably, the terms of the obligation) leaving one to discern how that document should be read. The reasoning appears to have been that, where interest arises from an obligation, the question of whether the interest falls within Schedule D Case III depends on where that obligation is located. The basic premise could be said to be that the "source" of the interest is the obligation itself.

Lord Hailsham's starting point, as he stated, was that some territorial limitation must apply following the principle set out by Lord Herschell in *Colquhoun v Brooks*[129]:

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

Lord Hailsham identified the key question as being[130] "whether or not the source of the payments by the [successor guarantor]…was…situated within the United Kingdom" and concluded that, on the facts, the "source of the obligation in question" (which he took to be the obligation of the principal debtor to make payments of interest under the bonds) was situated outside the UK.

This focus on the source of obligation appears to have been, at least implicitly, accepted by the Court of Appeal in *Ardmore CA* when Arden LJ stated that "[t]he *immediate* search is for the source of the interest *rather than* a search indirectly for the source of the loan"[131] (emphasis added).

[126] *BMBF*, above fn.114, [2004] UKHL 51.
[127] *National Bank of Greece HL*, above fn.8, [1971] AC 945.
[128] *National Bank of Greece HL*, above fn.8, [1971] AC 945 at 955. The UT was of the view, in *Ardmore UT*, above fn.18, [2015] UKUT 633 (TCC) at [29], that Lord Hailsham was, in this sentence, "emphasising that the source had not changed" as a result of the change in guarantor and that he is to be understood as saying "not that the nationality of the loan instrument falls to be ascertained by reference to all relevant factors, but that it is the source of the obligation that must be so ascertained".
[129] *Colquhoun*, above fn.39, (1889) 2 TC 490 at 499H.
[130] *National Bank of Greece HL*, above fn.8, [1971] AC 945 at 954.
[131] *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438 at [42].

It seems that once this is accepted, it is difficult, even if it were desirable to do so, to escape from the basic question of construction posed by UK statute so as to move, for example, to a more general discussion of "what is the source of the credit?" However, the rather more fundamental point this raises is that a "practical" view (here in the sense of "realistic view" as required by *BMBF*[132]) of all the factors bearing on the source of an obligation invites consideration of legal concepts and, indeed, requires a balanced understanding of those legal concepts.

Bringing the analysis back to core legal concepts is important because those concepts necessarily provide the foundation for any "practical" assessment of the source of an obligation (which is, itself, inherently a "legal" concept because it carries with it the connotation that an obligation is something that the law will enforce). Recognising the importance of concepts that have been developed through their use in the courts can offer rigour (and a structure) by virtue of which the law can be (as surely it ought to be) clear (if not, necessarily, always quite certain). Such an approach requires, as the House of Lords put it in *BMBF*, an unblinkered approach to the analysis of the facts when asking the ultimate question, which is "whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically".[133]

An obvious place to look for such a legal concept lies in the private international law approach to the residence of the debtor. Ever since the *National Bank of Greece HL* case,[134] the courts have flirted with this type of approach. Private international law principles were, for example, cited before the Court of Appeal in *Westminster Bank Executor and Trustee Co (Channel Islands) Ltd v National Bank of Greece SA*[135] itself and, indeed, in *Lever Brothers*[136] Watermeyer CJ considered and then rejected such principles. Furthermore, in November 1993[137] the Inland Revenue identified the debtor's residence as one of four of the most important factors determining residence and HMRC's SAIM Manual,[138] prior to amendments made in June 2019 in response to the Court of Appeal's judgment in *Ardmore CA*,[139] listed "residence" as being a "principal" factor (a view which at every stage of the proceedings Counsel for HMRC, ultimately successfully, sought to persuade the Tribunals and Court of Appeal not to endorse). However, the extent to which this resistance is well conceived may, it is suggested, be open to question on four fronts.

First, if the starting point as a matter of statutory construction is how to answer the question "what is the source of an obligation to pay interest", there seems to be a natural logic in drawing on the approach taken by the general law to such a question and, therefore, to the private international law concept of "residence".

[132] *BMBF*, above fn.114, [2004] UKHL 51.
[133] *BMBF*, above fn.114, [2004] UKHL 51 at [36], referring to Ribeiro PJ in *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 46 at [35]: "[T]he driving principle in the Ramsay line of cases continues to involve a general rule of statutory construction and an unblinkered approach to the analysis of the facts. The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically."
[134] *National Bank of Greece HL*, above fn.8, [1971] AC 945.
[135] *National Bank of Greece CA*, above fn.39, [1970] 1 QB 256.
[136] *Lever Brothers*, above fn.22, 14 SATC 1; [1946] AD 441.
[137] Revenue Interpretation, RI 58; originally published in the *Inland Revenue Tax Bulletin*, "Meaning of 'Source'", Issue 9, November 1993.
[138] HMRC, SAIM, above fn.6.
[139] *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438.

Secondly, HMRC's (and, prior to 2005, the Inland Revenue's) approach to "residence" for many years showed a tendency to confuse "residence" with "enforcement", as evidenced by the Inland Revenue's reference in November 1993 to the "the residence of the debtor, i.e. the place in which the debt will be enforced".[140] The position was explained back in 1931 by Romer LJ in *Deutsche Bank und Disconto Gesellschaft v Banque des Marchands de Moscou* where he described the position as follows[141]:

> "The reason for assigning this locality to a simple contract debt was that the place where the debtor resides was in nearly every case the place where it was recoverable. Even in earlier times, it might, of course, occasionally have happened that judgment could be obtained against a debtor in a country where he did not reside. But it was probably thought desirable for the sake of uniformity to adopt in all cases the test of residence rather than the test of recoverability."

This dictum encapsulates the point which emerges from the authorities, that the principal test for the situs of a debt is the residence of the debtor (rather than the place where the debt may be enforced). As Romer LJ observed, the place of enforceability may originally have been the rationale for taking the debtor's residence as the applicable criterion, but residence of the debtor, rather than place of enforceability, has become the governing principle.[142] More recently, in *Société Eram Shipping Co Ltd and others (Respondents) v Hong Kong and Shanghai Banking Corp Ltd (Appellants)* (*Société Eram Shipping Co Ltd*)[143] Lord Hobhouse, in a passage subsequently reaffirmed by the Supreme Court,[144] explained the relationship between situs and residence (which renders situs incapable of being applied independently of residence) thus[145]:

> "In the present case there is no dispute that the *situs* of the relevant debt is Hong Kong and not England.…But it is still necessary to understand why this is so. Stirling L.J. in *Martin v Nadel* [1906] 2 KB 26 at 31, like others before and since, found it most appropriate to refer to the work *Dicey: Conflict of Laws*. I will do the same, using the 13th edition (2000).[146]
>
> Rule 112 states that 'choses in action generally are situate in the country where they are properly recoverable or can be enforced'. The text amplifies this in relation to debts, saying, 'a debt is [generally] situate in the country where the debtor resides.…It may not, however, be the only place: English courts may take jurisdiction against non-residents on the basis of temporary presence', or under the CPR or the Brussels or Lugano Conventions. Nevertheless, this possibility does not make the debt situate in England if the debtor is not

[140] Revenue Interpretation, RI 58, above fn.137.
[141] *Deutsche Bank und Disconto Gesellschaft v Banque des Marchands de Moscou* 14 December 1931 (158 LT 1115-1116) (CA) as quoted by Roxburgh J in *Re Banque des Marchands de Moscou (Koupetschesky) (No.2)* [1954] 2 All ER 746; [1954] 1 WLR 1108 (Ch).
[142] See also L. Collins and R. Harris (eds), *Dicey, Morris and Collins on the Conflict of Laws*, 15th edn (London: Sweet and Maxwell, 2012), para.22-029.
[143] *Société Eram Shipping Co Ltd and others (Respondents) v Hong Kong and Shanghai Banking Corp Ltd (Appellants)* [2003] UKHL 30; [2004] 1 AC 260 at 287–288 per Lord Hobhouse.
[144] *Taurus Petroleum Ltd (Appellant) v State Oil Marketing Co of the Ministry of Oil, Republic of Iraq (Respondent)* (*Taurus Petroleum Ltd*) [2017] UKSC 64 at [30].
[145] *Société Eram Shipping Co Ltd*, above fn.143, [2003] UKHL 30 at [71]–[72]; [2004] 1 AC 260 at 287–288.
[146] L. Collins (ed.), *Dicey and Morris on the Conflict of Laws*, 13th edn (Sweet & Maxwell, 2000).

> resident here. But, generally speaking, 'for the purpose of determining situs, a corporation is resident wherever it carries on business': pp.925-926).
>
> 'Where…the debtor has two or more places of residence and the creditor either expressly or impliedly stipulates for payment at one of them, then the debt will be there situate. This refinement is important in connection with bank accounts where (as in English law) under the applicable law of the contract between banker and customer the bank's obligation to repay is performable primarily at the branch where the account is kept, and accordingly in such a case all accounts kept at a particular branch are to be held there situate….Where the debtor has more than one place of residence but there is no express or implied promise to pay at any one of them then the debt is situate at that place of residence where it would be paid in the ordinary course of business.' (pp.926-927)"[147]

Thirdly, private international law has itself matured.[148] The current rules dealing with conflicts of jurisdiction, at least as between EU Member States, are set out in Regulation 1215/2012/EU on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters.[149] Regulation 1215/2012/EU provides that "domicile" is the main ground for jurisdiction and the editors of the 15th edition of *Dicey, Morris and Collins on the Conflict of Laws* suggest that it is appropriate to interpret the test of residence, as applied in determining *situs* of debts, so as to take account of any developments in the law on choice of jurisdiction.[150] So, in short, there is a well-established body of case law identifying the place where a debtor is resident as the place where an obligation is located. Hence it is suggested that this is at least a very helpful starting point, where an obligation is to pay interest, for the purposes of determining the source of that interest.

Fourthly, the modern approach taken by private international law to ascertaining residence is not dictated by a rigid formalism, but by substantive considerations[151] and, therefore, looks to

[147] This, it is suggested, represents a much more logical and appealing approach than that pressed on the Court of Appeal by HMRC's Counsel in *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438, where it was suggested that dual residence should lessen the weighting given to the debtor's residence in determining the source of an interest payment.

[148] The impact of Brexit is not (as of late February 2020) known. However, Withdrawal Agreement Art.67(2)(a) published by the HM Government and presented to Parliament on 19 October 2019 (HM Government, *Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community* (19 October 2019)) provided that in the UK, as well as in the Member States in situations involving the UK, Regulation (EU) No 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters [2012] OJ L351/1 (Regulation 1215/2012/EU), should "apply to the recognition and enforcement of judgments given in legal proceedings instituted before the end of the transition period, and to authentic instruments formally drawn up or registered and court settlements approved or concluded before the end of the transition period". This does not address the position where legal proceedings are not begun before the end of the implementation period (prospectively, 31 December 2020). However, the European Union (Withdrawal) Act 2018 ss.2–7 (and, in particular, s.3) (as amended by the European Union (Withdrawal Agreement) Act 2020) seem designed to enable English law to remain substantively unaltered from the position established under the aegis of Regulation 1215/2012/EU where a conflict arises in relation to jurisdiction and needs to be resolved on or after "exit day".

[149] Regulation 1215/2012/EU, above fn.148, deals with choice of jurisdiction, rather than choice of law, by the court which has jurisdiction (which is the question that has been answered, in past case law, by looking at the situs of a debt based in turn on the residence of a debtor).

[150] Collins and Harris (eds), *Dicey, Morris and Collins on the Conflict of Laws*, 15th edn, above fn.142, para.22-032.

[151] By way of example, see *Taurus Petroleum Ltd*, above fn.144, [2017] UKSC 64 where the Supreme Court overruled a prior decision by the majority of the Court of Appeal in *Power Curber International Ltd v National Bank of Kuwait*

factors which are not apt to be distorted for the purposes of contrived abuse and thereby "go with the flow" of tax law in recent years. This can perhaps best be illustrated by the approach taken by the courts to dual residence, not least because this was considered by the Court of Appeal in *Ardmore CA*: Counsel for HMRC put it to the Court of Appeal in *Ardmore CA* that dual residence ought not to detract from the relevance of "residence" because where dual residence occurs this can be reflected in the weighting accorded to that factor; a view with which Arden LJ appeared inclined to agree, expressing the view that this was "consistent with an approach based on a commercial basis rather than on legal factors".[152] However, the private international law approach that where a debtor has more than one place of residence but there is no express or implied promise to pay at any one of them, then the debt is situated (and the debtor is treated as being resident) where that debt would be paid in the ordinary course of business, seems a rather sensible way of resolving such a question in relation to dual residence (at least in the case of a financial institution offering its customers accounts in different jurisdictions).

If "residence" is allowed to serve as a starting point, the question that this leaves unanswered is to what extent other factors should be taken into consideration, and, for that, no simple answer presents itself. But, as should be apparent from what has been said above, delegating the responsibility for identifying source as a "practical hard matter of fact" to a "practical person" is more of an unhelpful distraction than a panacea.

Conclusion

To the extent that the "practical approach", and the treatment of source, as a "practical hard matter of fact" is taken to be fairly much synonymous with the view of the "practical man" referred to by Isaacs J in *Nathan*,[153] that practical man (prior to *Ardmore CA*) may be said to have originally sported an Australian domicile, then emigrated to South Africa by the mid-1920s and finally passed away (at least as a diviner of the source of interest) on 1 January 2012. His substantive achievements in South Africa, other than as a Loki-like spreader of confusion, were non-existent despite a number of attempts to find a gainful use for his talents, whether as a benign patron of, or as a moderating influence on, the otherwise potentially unfair consequences of the doctrine of "originating source" adopted by the South African courts in *Lever Brothers*[154] (and subsequently refined by reference to the concept of a "dominant" source). Eddie Broomberg SC, referring to what he termed the "meme merchants" who handed down South African income tax judgments from the late 1960s to the early 1980s,[155] concluded that

> "…this generation of jurists proved to be the master of the catchphrase, coining or purloining aphorisms which sometimes virtually assumed the status of legal principal…
>
> Some of these juristic maxims are not home-grown…

SAK [1981] 1 WLR 1233 and held, unanimously, that the *situs* rule is no different for a letter of credit than it is for any other debt.

[152] *Ardmore CA*, above fn.1, [2018] EWCA Civ 1438 at [30].

[153] *Nathan*, above fn.85, [1918] HCA 45; 25 CLR 183.

[154] *Lever Brothers*, above fn.22, 14 SATC 1; [1946] AD 441.

[155] E. Broomberg SC, "A century of income tax jurisprudence in South Africa" in Hattingh, Roeleveld and West, above fn.48, 202–203.

> …these aphorisms may be downright misleading, such as the frequently quoted observation by Isaacs J. in *Nathan v F. Commissioner of Taxes*, to the effect that the source of a given amount of income is a 'practical hard matter of fact'. A moment's reflection will reveal that in reality it is none of those things; it is a fuzzy rather than a hard concept and as long as the approach…in *Lever Brothers* holds good, namely that the origin of all income must be attributed to the services rendered by the taxpayer, it is certainly not practical."

It is a further reflection of the difficulties created by the approach advocated by Isaacs J that other commentators, seeking to draw upon the subtle differences in the arguments of each of the judgments handed down in *Lever Brothers*,[156] have argued that the "practical man" principle should be applied not in lieu of legal theory, but to restrain its unbridled use when unjust results would ensue.[157]

It is, hopefully, apparent from what has been said above that a focus on a "practical hard matter of fact" is not required as a matter of authority following the *National Bank of Greece HL* case,[158] that to seek to rely upon the viewpoint of a "practical person" is to ignore the experience gained (painfully, as South African case law indicates) in South Africa as well as in Australia, and (if the law is to provide clarity) is not to be recommended. ☙

[156] Foreshadowed, perhaps, by Davis AJA's observation that "the person whom Lord Atkin had in mind was the practical man and not the legal theorist who, by resolutely shutting his eyes to all the facts, could prove that black was white": *Lever Brothers*, above fn.22, [1946] AD 441; 14 SATC 1 at 23–24.
[157] E.M. Stack, D. Grenville, R. Poole, H. Harnett and E. Horn, "Commissioner for Inland Revenue v Lever Brothers: A practical problem of source" (2015) 19 *South African Business Review Special Edition Tax Stories* 161.
[158] *National Bank of Greece HL*, above fn.8, [1971] AC 945.

☙ Australia; Comparative law; Income tax; Interest; Loans; Place; South Africa