Analysis

Burlington in the UT: a clearer approach

Speed read

The Upper Tribunal in *Burlington Loan Management DAC* dismissed HMRC's appeal, holding that HMRC was wrong to apply a UK-centric approach to the interpretation of the UK/Irish double tax treaty and instead applying one based on the object and purpose of the treaty. Only arrangements which secure an allocation of taxing rights between the UK and Ireland that is contrary to that object and purpose would fall afoul of the anti-abuse rule in the treaty.

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UK tax has to be withheld from interest payments to Cayman-resident companies but, if the UK/Irish treaty applies, not from those to Irish-resident companies. A Cayman company looking down the barrel of an interest payment with UK withholding tax might therefore naturally seek to sell the debt to an Irish company; the two can set the price so as to split the benefit of the withholding tax saving. The question in *HMRC v Burlington Loan Management DAC* [2024] UKUT 152 (TCC) was whether doing so was enough to have a 'main purpose of taking advantage' of treaty benefits and therefore rescind them.

The First-tier Tribunal (FTT) held that this wasn't enough, as I reported in this journal ('*Burlington* and treaty purpose tests', *Tax Journal*, 16 September 2022); it found for the taxpayer. HMRC appealed to the Upper Tribunal (UT), which has dismissed the appeal.

What purpose was required?

A fuller description of the facts can be found in my article on the FTT decision, but a brief overview is all that is needed to understand the UT decision. The Cayman company was called SICL, and the Irish company was Burlington Loan Management DAC. SICL was due to be paid interest on the surplus arising out of the administration of Lehman Brothers International (Europe) and knew UK withholding tax would be deducted; it found a broker who bought the right to be paid the interest for 90.8% of the face value and on-sold it to Burlington for 92%. Importantly, SICL didn't learn of Burlington's identity until relatively late in the negotiations, after the price had been agreed.

HMRC argued before the FTT that relief under the Irish treaty was not available because 'it was the main purpose or one of the main purposes of any person concerned with the creation or assignment of the debt-claim ... to take advantage' of the exemption from withholding tax in the treaty. The FTT dismissed this argument, saying that the transferor must know that the purchaser is entitled to the benefit of the interest article in the Irish treaty specifically, not just that it might benefit from some withholding tax exemption, for this anti-abuse rule to apply. On appeal, HMRC challenged this as wrong in law.

Before the FTT, the parties agreed that the starting point in interpreting the anti-abuse rule was the ordinary meaning of the words, using UK domestic case law to interpret words like 'main purpose'. The FTT followed this approach. The UT, tacitly disapproving of this, started with the object and purpose of the treaty and the interest article. It said that its purpose was simply to allocate taxing rights to interest between the UK and Ireland. It was wrong for HMRC to interpret the main purpose test as though it were a test in a UK statute seeking to deny UK tax benefits if a taxpayer had a main purpose of relying on them.

So the UT did not accept HMRC's suggestion that all that was needed was the knowledge that in principle some withholding tax exemption must be expected given Burlington was offering more than 80% of the face value of the interest. But it didn't agree with the FTT's conclusion that it was necessary to know of the Irish interest article in particular. Instead, the real question was 'whether there is something abusive, in the particular circumstances of this case, for Ireland alone to tax interest beneficially owned by a company resident in its territory'.

> The question that must be asked is whether in the circumstances it would be contrary to the object and purpose of the interest article to give Ireland sole taxing rights, and none to the UK as source state

Burlington had proposed that this requirement for abuse meant that only artificial transactions could be caught; as it had bought the interest in a straightforward way it could therefore not be within the scope of the rule. The UT didn't accept this. There had to be something 'abusive' to turn off treaty benefits, something which, like a conduit company inserted in the classic treaty shopping case, would frustrate the object and purpose of the treaty itself in allocating taxing rights between the UK and Ireland. But it didn't follow that that the situations which might be abusive must also be artificial.

So, in summary, the UT held that the question of whether someone has an impermissible purpose for the purpose of the Irish treaty is a question of whether they have a main purpose of UK withholding tax not applying in a situation where that allocation of the taxing rights would be contrary to the purpose of the treaty. Whilst not limited to situations of treaty shopping or conduit companies, those are paradigmatic examples of the category of transactions which might trigger the anti-abuse rule here.

What about the pricing?

Burlington only paid the price it did (92% of the face value of the interest) because it thought treaty benefits were available and the UK could not impose withholding tax. Without treaty benefits, the deal would not have happened: no buyer would pay more than 80%, given the 20% UK withholding tax rate. HMRC argued that this pricing must mean, without needing anything more, that there was

a main purpose of taking advantage of the treaty. Even worse, the pricing had the effect of giving SICL, a Cayman company, part of the economic upside of Burlington's Irish treaty benefits.

HMRC's argument had to surmount two hurdles to success in the UT. The first was that it doesn't address the UT's decision that HMRC must prove not just that the treaty benefits were assumed to have existed but that they were intended to be used in a way that was contrary to the purpose of the treaty. A purely economic argument couldn't get HMRC home on this point. But more importantly HMRC's argument was that the FTT had not given sufficient salience to the pricing point in the 'evaluative exercise' it undertook to identify the main purpose of SCIL and Burlington. The UT said that this kind of fact-based assessment should be left to the discretion of the FTT (as the fact-finding tribunal) unless a clear flaw in the FTT's logic was apparent (which it wasn't).

HMRC raised a number of other objections to factual findings of the FTT or the way those findings were used in the evaluative exercise, which the UT dispatched summarily. HMRC also attempted to argue along *Edwards v Bairstow* [1956] AC 14 (HL) grounds that the decision reached by the FTT was one no reasonable tribunal could have reached. This was similarly unsuccessful.

Comment

While the UT dismissed HMRC's appeal, it also overturned the FTT's holding that knowledge of the expected UK/Irish treaty benefits was required before having a main purpose of taking advantage of that treaty. At first blush, it might be confusing to see how someone can have a main purpose of taking advantage of a treaty they don't know exists or is relevant. An example might help. Say, in this case, SICL's broker had identified a Cayman buyer, rather than Burlington, who offered more than 80% for the interest assignment. When prompted, the broker relayed to SICL that the Cayman buyer was going to insert one of its shell companies in a jurisdiction with a treaty with the UK to ensure there was no UK withholding tax, but didn't specify which. In that situation, a tribunal could well find that SICL would have had a main purpose of taking advantage of whatever UK treaty ended up actually being relevant.

One of the difficulties with the FTT decision I wrote about previously was its extensive reliance on UK domestic law cases on 'purpose', including *Mallalieu v Drummond* [1983] STC 665, *Vodafone v Shaw* [1997] STC 734 and the UT decision in *BlackRock* [2022] UKUT 199 (TCC). The UT largely eschewed this, preferring an approach to the interpretation of the treaty based on its history, OECD commentary, and its object and purpose. This also informed its approach to what 'take advantage' means, providing some helpful colour: the question that must be asked is whether in the circumstances it would be contrary to the object and purpose of the interest article to give Ireland sole taxing rights, and none to the UK as source state. Whilst it will not be a complete answer in all cases, in general this is likely to mean that in situations where the buyer is a genuine Irish resident who is beneficially entitled to the interest, the anti-avoidance article is unlikely to bite. ■

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- Cases: *HMRC v Burlington Loan Management DAC* (11.6.24)
- *Burlington* and treaty purpose tests (K Rainsford, 15.9.22)