13 March 2019

PRESS SUMMARY

Commissioners for Her Majesty's Revenue and Customs (Respondent) v Joint Administrators of Lehman Brothers International (Europe) (In Administration) (Appellants) [2019] UKSC 12
On appeal from: [2017] EWCA Civ 2124

JUSTICES: Lord Reed (Deputy President), Lord Carnwath, Lord Hodge, Lady Black, Lord Briggs

BACKGROUND TO THE APPEAL

This appeal concerns the final stage of the administration of Lehman Brothers International (Europe) ("LBIE"). It became commercially insolvent due to the worldwide crash of the Lehman group. LBIE went into administration on 15 September 2008. The administration generated an unprecedented surplus in the region of £7 billion. It is estimated that about £5 billion is payable as statutory interest. All unsecured creditors have already been repaid the principal sums owed, in full, by 30 April 2014.

The question on appeal is whether interest payable under rule 14.23(7) of the Insolvency Rules 2016 ("the 2016 Rules") is "yearly interest" within the meaning of section 874 of the Income Tax Act 2007 ("the 2007 Act"). If so, the administrators must deduct income tax before paying interest to creditors.

In the High Court, Mr Justice Hildyard considered that statutory interest under rule 14.23(7) is not "yearly interest" for the purposes of the 2007 Act. This was because of the absence of any accrual of interest over time, before the surplus was identified and quantified. The Court of Appeal disagreed, allowing the appeal by the Commissioners ("HMRC"). It considered that interest under rule 14.23(7) is indeed "yearly interest". It did not accept a requirement that yearly interest should accrue over time and considered that, because the statutory interest was compensation for the creditors, it had the required long-term quality. The administrators now appeal to the Supreme Court.

JUDGMENT

The Supreme Court dismisses the appeal. Lord Briggs gives the lead judgment, with which all members of the Court agree. Income tax must be deducted before payment of statutory interest to the creditors.

REASONS FOR THE JUDGMENT

Rule 14.23(7) of the 2016 Rules, which replaced substantially identical provisions in rule 2.88(7) of the Insolvency Rules 1986, requires a surplus after payment of proved debts in an administration to be used for payment of statutory interest **[1]**. Interest is paid as statutory compensation for the loss which the creditors have suffered by being kept out of their money during the administration **[6]**.

Section 874 of the 2007 Act, which is a much more historic provision within the income tax legislation, requires a debtor to deduct income tax from payments of "yearly interest" arising in the UK **[1, 11-15]**. Historically, the income tax legislation adopted a dichotomy between the treatment of interest of any kind which is not paid out of profits or gains, on the one hand, and yearly interest, on the other hand **[15]**. The mandatory deduction at source of yearly interest remains in place for interest paid by companies as well as certain other categories of taxpayers, and interest paid by any person to someone whose usual place of abode is outside the UK **[15]**.

There are two lines of English and Scottish case law that are relevant to this appeal. The first deals with whether interest which accrues over time is properly categorised as yearly interest **[20]**. The second is mainly concerned with interest payable as a result of a judicial decision, either when granting an equitable remedy or when exercising a discretion to award interest under statute **[20]**. However, statutory interest under rule 14.23(7) of the 2016 Rules does not strictly fall within either category. The answer to the question on appeal must thus be found by analogy **[20]**.

In the first line of cases, a number of general tests for whether interest is yearly interest or not were laid down **[21-29]**. These were summarised by the Court of Session in *Inland Revenue Comrs v Hay* (1924) VIII TC 636 ("the *Hay* tests"). In summary: (1) interest payable on so-called short loans is not yearly interest; (2) for interest to be yearly interest, there must be some element of permanence in the contractual arrangement under which it is payable; (3) the arrangement under which interest is payable must be in the nature of an investment; (4) the loan must not be one repayable on demand; and (5) there must be some 'tract of future time' during which interest will continue to be payable **[30]**. The *Hay* tests remain the best convenient summary about the meaning of yearly interest in the context of interest which accrues over time **[33]**.

In the second line of cases, the same question has been addressed in the context of interest usually payable in a single lump sum **[34]**. The most important case is the House of Lords decision in *Riches v Westminster Bank Ltd* [1947] AC 390 **[36-42]**. In most of these cases, interest became payable only after the event (and usually in one lump sum) upon the order of the court and it served as compensation for being deprived of money or property during a past period **[34, 47-48]**. Relevant examples include cases where a trustee has misused trust property and cases where the court has ordered interest to be paid on damages, such as for personal injury, until the date of judgment **[34-48]**. Where that period exceeds a year, interest was held to be yearly interest for income tax purposes **[52]**.

Interest payable on a surplus in an administration is of a special type **[49]**. Such interest, once paid, compensates proving creditors for being kept out of their proved debts in respect of the period from the beginning of the administration until they are actually paid **[49]**. Consequently, the relevant analogy is to the second line of cases **[47-48, 52]**. This is because in both the present appeal and those cases there is no liability to pay interest during the period in respect of which it is calculated, and the interest is not itself payable over a period of time **[47-48]**. Moreover, in both cases, it cannot be known during the period of calculation whether interest will in fact be payable at all **[47-48]**. In both, the interest amounts to compensation for the recipients having been out of their money **[48, 52]**. There is no relevant uncertainty, because, like in the trust and personal injury cases, the taxpayer will know to which period the interest relates by the time it becomes due and thus make suitable tax deductions **[54]**. In the present case, the period is fixed by the date of commencement of the administration and the date (or dates) when the proving creditors are paid their debts **[54]**.

Arguments based on the source of the relevant income conflict with the second line of cases **[55-56].** Further, they are wrong in principle as: (1) the income tax deduction obligation under section 874 of the 2007 Act does not depend on whether the interest is taxable in the hands of the recipient; (2) it is artificial to regard the source of statutory interest as either the realisation of the surplus or the administrators' decision to pay interest; and (3), if anything, the relevant status of the recipient is as a proving creditor between the start of the administration and payment of the principal debt **[57-59]**.

On the present facts, the result is that the statutory interest payable is yearly interest **[61]**. Therefore, income tax is to be deducted at source pursuant to section 874 of the 2007 Act **[61]**.

References in square brackets are to paragraphs in the judgment.

NOTE
This summary is provided to assist in understanding the Court's decision. It does not form part of the reasons for the decision. The full judgment of the Court is the only authoritative document. Judgments are public documents and are available at:
http://supremecourt.uk/decided-cases/index.html