Hilary Term

[2019] UKSC 12

On appeal from: [2017] EWCA Civ 2124

JUDGMENT

Commissioners for Her Majesty's Revenue and Customs (Respondent) v Joint Administrators of Lehman Brothers International (Europe) (In Administration) (Appellants)

before

Lord Reed, Deputy President

Lord Carnwath

Lord Hodge

Lady Black

Lord Briggs

JUDGMENT GIVEN ON

13 March 2019

Heard on 12 February 2019

Appellants	Respondent
David Goldberg QC	Malcolm Gammie CBE QC
Daniel Bayfield QC	Catherine Addy QC
(Instructed by Linklaters LLP)	(Instructed by HMRC Solicitor's Office and Legal Services)

LORD BRIGGS: (with whom Lord Reed, Lord Carnwath, Lord Hodge and Lady Black agree)

Introduction

1.

This appeal concerns the relationship between two statutory provisions, one very old and the other very young. The old provision, which dates back to the inception of Income Tax during the Napoleonic Wars, but is now to be found in section 874 of the Income Tax Act 2007, requires a debtor in specific circumstances to deduct income tax from payments of "yearly interest" arising in the United Kingdom. The young provision, first made the subject of legislation in 1986 (and replacing previous judge-made rules) but now to be found in rule 14.23(7) of the Insolvency Rules 2016, requires a surplus remaining after payment of debts proved in a distributing administration first to be applied in paying interest on

those debts in respect of the periods during which they had been outstanding since the commencement of the administration. The short question, which has generated different answers in the courts below, is whether interest payable under rule 14.23(7) is "yearly interest" within the meaning of section 874, so that the administrators must first deduct income tax before paying interest to proving creditors.

2.
The question arises in connection with the administration of Lehman Brothers International (Europe) ("LBIE") which, although it commenced at a time when LBIE was commercially insolvent due to the worldwide crash of the international group of companies of which it formed an important part, has nonetheless generated an unprecedented surplus after payment of all provable debts, in the region of £7 billion, of which some £5 billion is estimated to be payable by way of statutory interest (before any deduction of income tax). LBIE went into administration on 15 September 2008. It became a distributing administration in December 2009. A final dividend was paid to unsecured proving creditors (bringing the total dividends to 100p in the pound) on 30 April 2014. After the coming into effect of a scheme of arrangement, interest slightly in excess of £4 billion was paid to creditors, after deduction of a sufficient amount on account of tax to abide the outcome of these proceedings, on 25 July 2018. Thus the time which elapsed between the commencement of the administration and the payment of interest to creditors was slightly under ten years. The periods in respect of which interest was payable under rule 14.23(7) (and its predecessor) ranged from a little over four years (which expired when the first interim distribution to proving creditors was made in November 2012) and little over five and a half years, when the final dividend to creditors was made, as described above.

Statutory Interest in Administration

3.
Rule 14.23(7) of the Insolvency Rules 2016, which replaced substantially identical provisions in rule 2.88(7) of the Insolvency Rules 1986, provides as follows:

"(7) In an administration -

(a) any surplus remaining after payment of the debts proved must, before being applied for any other purpose, be applied in paying interest on those debts in respect of the periods during which they have been outstanding since the relevant date;

(b) all interest payable under sub-paragraph (a) ranks equally whether or not the debts on which it is payable rank equally; and

(c) the rate of interest payable under sub-paragraph (a) is whichever is the greater of the rates specified under paragraph (6) and the rate applicable to the debt apart from the administration."

4.
Rule 14.23(6) provides that the relevant rate of interest is that specified in section 17 of the Judgments Act 1838 (1 & 2 Vict c 110), which was, at the material time, 8% per annum. The "relevant date" referred to in rule 14.23(7)(a) is the date upon which the company entered administration; see rule 14.1(3).

5.
In In re Lehman Brothers International (Europe) (in administration) (No 6) [2015] EWHC Civ 2269 (Ch); [2016] Bus LR 17, para 149, David Richards J said this about statutory interest payable under the predecessor of rule 14.23(7):

“The right to interest out of a surplus under rule 2.88 is not a right to the payment of interest accruing due from time to time during the period between the commencement of the administration and the payment of the dividend or dividends on the proved debts. The dividends cannot be appropriated between the proved debts and interest accruing due under rule 2.88, because at the date of the dividends no interest was payable at that time pursuant to rule 2.88. The entitlement under rule 2.88 to interest is a purely statutory entitlement, arising once there is a surplus and payable only out of that surplus. The entitlement under rule 2.88 does not involve any remission to contractual or other rights existing apart from the administration. It is a fundamental feature of rule 2.88, and a primary recommendation of the Cork Committee that all creditors should be entitled to receive interest out of surplus in respect of the periods before payment of dividends on their proved debts, irrespective of whether, apart from the insolvency process, those debts would carry interest.”

6.
In the present case, in the Court of Appeal [2018] Bus LR 730, after citing that passage in full, Patten LJ continued, at para 16:

“There is no doubt at all that statutory interest, as David Richards J explained, is not a continuing liability which accrues from day to day on a prospective basis over the period to which it relates. It is paid, as I have said, as statutory compensation for the loss which the creditors have suffered by being kept out of their money for the period of the administration.”

I agree.

7.
In In re Lehman Brothers International (Europe) (in administration) (Nos 6 and 7) [2017] EWCA Civ 1462; [2018] Bus LR 508, para 26, giving the judgment of the Court of Appeal, Gloster LJ said of the simple words of rule 2.88(7), when aggregated with the following two paragraphs (all in substantially the same terms as are now to be found in rule 14.23, as set out above):

“… this simple formula constitutes, in our view, a complete and clear code for the award of statutory interest on provable debts. As [counsel] put it, it contains all you need to know.”

In the present case, at first instance, Hildyard J said at para 16:

“In my judgment, the statutory right to interest is sui generis and is not to be equated with a right to interest which accrues over time.”

Again, I agree with both those dicta (and was a party to the first of them).

Yearly Interest under the Income Tax Legislation

8.
Section 874 of the Income Tax Act 2007 provides (so far as is relevant) as follows:

“(1) This section applies if a payment of yearly interest arising in the United Kingdom is made -

(a) by a company,

(b) by a local authority,

(c) by or on behalf of a partnership of which a company is a member, or

(d) by any person to another person whose usual place of abode is outside the United Kingdom.

(2) The person by or through whom the payment is made must, on making the payment, deduct from it a sum representing income tax on it at the basic rate in force for the tax year in which it is made."

There is no definition of the phrase "yearly interest" anywhere in the 2007 Act. Nonetheless there is this deeming provision in section 874, added by Schedule 11 to the Finance Act 2013:

"(5A) For the purposes of subsection (1) a payment of interest which is payable to an individual in respect of compensation is to be treated as a payment of yearly interest (irrespective of the period in respect of which the interest is paid)."

9.
This is unfortunately another case in which the full meaning of an apparently innocent-looking simple statutory phrase can only be addressed by reference to the historical deployment of that phrase, or equivalent phrases seeking to express the same concept, in early legislation.

10.
Hildyard J set out in an Appendix to his judgment an admirable brief summary of the history of the statutory provisions about deduction of yearly interest, beginning with the introduction of income tax by Pitt's Income Tax Act 1799 (39 Geo 3 c 13). In the present case, the main reason for needing an understanding of the statutory history is so that important decisions about the underlying concepts behind yearly interest can be reliably interpreted, by reference to the particular context of the use of the phrase in the statute then in force. As would appear, the earliest of those authorities was decided in 1854, and the latest in 1981.

11.
The concept of "yearly interest" first appeared within the income tax legislation in section 208 of Addington's Income Tax Act 1803 (43 Geo 3 c 122). It appeared as part of the phrase:

"Annuities, yearly Interest of Money, or other annual Payments … whether the same shall be received and payable half-yearly, or at any shorter or more distant Periods."

Section 208 both charged yearly interest to tax and authorised the payer to deduct an amount equal to the tax chargeable on the interest.

12.
When income tax was reintroduced by Sir Robert Peel in the Income Tax Act 1842 (5 & 6 Vict c 35), section 102 charged to tax:

"Annuities, yearly Interest of Money, or other annual Payments."

And, as in 1803, provided for deduction at source by the payer, where paid out of taxed profits or gains.

13.
Deduction of yearly interest at source was continued in Gladstone's Income Tax Act 1853 (16 & 17 Vict c 34), by section 40, while Schedule D brought into charge:

"All Interest of Money, Annuities, and other annual Profits and Gains."

14.
From 1888 until 1965, a succession of provisions to substantially the same effect made it compulsory to deduct tax at source and to account for it to the Revenue where interest of any kind was not wholly paid out of taxed income, but permitted the deduction of tax at source and its retention in respect of

yearly interest which was wholly paid out of taxed income. In relation to yearly interest, this enabled the interest payer to be compensated for the fact that yearly interest paid out was not deductible in computing his own taxable profits or gains. This dichotomy was, between 1918 and 1952, achieved by rules 21 and 19 respectively of the General Rules Applicable to all Schedules of the Income Tax Act 1918 ("the 1918 Rules"). In short, rule 21 was about all types of interest, whereas rule 19 was concerned only with yearly interest. From 1952 until 1965 this dichotomy was preserved by sections 169 (concerning yearly interest) and 170 (concerning interest of any kind) of the Income Tax Act 1952.

15.
This dichotomy between the treatment of interest of any kind which is not paid out of profits or gains and yearly interest which is so made was progressively unwound, first for corporate taxpayers by the Finance Act 1965 and then generally by the Finance Act 1969. The regime for deduction of tax on interest at source which has continued, without substantial change, from 1969 is that set out in section 54 of the Income and Corporation Taxes Act 1970, then section 349(2) and (3) Income and Corporation Taxes Act 1988 and, latterly, section 874 of the Income Tax Act 2007. In summary, it provides only for the mandatory deduction at source of tax on yearly interest paid by companies as well as certain other categories of payers, or paid by any person to someone whose usual place of abode is outside the UK.

The issues

16.
In order to make sense of what follows, it is convenient at this stage to provide a bare outline of what is and is not in issue, under the general question whether or not statutory interest payable by administrators out of a surplus is yearly interest. It has been common ground throughout this litigation that the payments are properly to be regarded as interest, not merely because they are so described in rule 14.23(7), but also within the meaning of the word as used in section 874(1). As will appear (and as the Court of Appeal concluded) that apparent concession by the administrators serves more to mask than to define the real issues.

17.
The main thrust of the administrators' submissions (by Mr David Goldberg QC and Mr Daniel Bayfield QC in this court although Mr Goldberg did not appear below) has been to contrast the characteristics which the authorities show are required for the classification of interest as yearly interest with those of interest payable from a surplus in administration. The required characteristics are that the interest should derive from a source with the requisite degree of permanence and durability over time, and that the interest should accrue due over a period intended, or at least likely to last for a year or more. By contrast, it is submitted, statutory interest payable from a surplus in administration has, as its source, first the emergence of a surplus and second the decision of the administrators that it is time to pay it. It does not accrue due over any significant or likely period of time. Rather it is simply payable out of that surplus once it has been ascertained and turned into money, usually (and as here) by a single payment of a lump sum to each qualifying creditor.

18.
For HMRC it is submitted (by Mr Malcolm Gammie QC and Ms Catherine Addy QC) first, that it is unnecessary to identify a source for a statutory interest payment to qualify for deduction under section 874(1) and secondly, that it is not a requirement of yearly interest that it should accrue due over a period of time. Rather, the characteristic which satisfies the requirement that the interest

should be yearly is that, once a surplus has been identified, the statutory interest is payable in respect of the period, commencing with the beginning of the administration, and ending with payment of the proving creditors' debts in full, during which the creditors have been kept out of their money. If that period is, on the facts about a particular administration, in excess of a year, then the requirement for duration over time encapsulated in the word "yearly" is satisfied. Further, to the extent that the authorities made it a requirement that the source of the interest should be something in the nature of an investment, this was satisfied in relation to all LBIE's creditors, and regardless of the basis of their claims admitted to proof, because they were involuntary long-term investors in LBIE by reason of the moratorium placed upon their claims by its administration.

19.
At first instance, Hildyard J was persuaded that the absence of any accrual over time (prior to the identification of a surplus and its quantification after payment of all proved debts in full) was fatal to the categorisation of statutory interest as yearly interest. By contrast, the Court of Appeal could discern no requirement from the authorities that yearly interest should accrue due over time. Since it was compensation for the proving creditors being kept out of their money for a substantial time, the interest had the requisite long-term quality sufficient for it to be categorised as yearly.

The Authorities

20.
The relevant authorities may broadly be divided into two groups. First, there are those which address the question whether interest which does accrue due over time is properly to be categorised as yearly interest or, in bankers' jargon, "short interest". Secondly, there are those authorities which address the question whether an entitlement to money described as interest, but which does not accrue due over time, can properly be regarded as yearly interest, or indeed interest at all, within the meaning of the income tax legislation. This second group 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. As will appear, it is this second group of authorities which, in my view, provides the answer to the questions raised by this appeal, albeit only by analogy because, as the judge himself observed, statutory interest payable from a surplus realised in a distributing administration is sui generis. Nevertheless it is convenient to take the first (generally earlier) group of authorities first.

21.
The earliest is Bebb v Bunny (1854) 1 K & J 216. The question was whether interest contractually payable upon the late completion of a contract for the purchase of land was yearly interest of money within the meaning of section 40 of the Income Tax Act 1853, so that it was payable subject to deduction of tax, either by the purchaser or by the court, even if paid into court gross as the condition for a decree of specific performance against the vendor. In deciding that it was yearly interest, Sir William Page Wood V-C said, at pp 219-220:

"The whole difficulty is in the expression 'yearly' interest of money; but I think it susceptible of this view, that it is interest reserved, at a given rate per cent per annum; or, at least, in the construction of this Act, I must hold that any interest which may be or become payable de anno in annum, though accruing de die in diem, is within the 40th section. I cannot make any solid distinction between interest on mortgage money and interest on purchase-money. … I consider the Act very singularly worded, yearly interest being used apparently in the same sense as annual payments; but I am clearly of opinion that it means at least all interest at a yearly rate, and which may have to be paid de anno in

annum; such as interest on purchase-money, as well as mortgage interest; and that, therefore, the purchaser is entitled to deduct the tax in this case."

22.
The reference to mortgage money, by way of analogy, becomes intelligible when it is understood that the drafting practice of the time was typically to make mortgage loans repayable, with interest, on a fixed date, usually less than a year after the making of the advance, even if the parties' expectation was that the mortgage would endure for much longer, before redemption, with interest being payable periodically in the meantime. As the Vice Chancellor put it, at p 218:

"Most mortgage deeds contain only a covenant to pay the principal, with interest at a certain rate per annum, on a day certain. After that it accrues de die in diem, and the interest, without any particular reservation, ordinarily is received half-yearly, from year to year. It is difficult to see the distinction between interest so reserved and paid, and that which by special agreement accrues on purchase-money, which also goes on from day to day, and may run on for a year or stop at any time on payment of the purchase money, and which, in some shape or other, forms a lien on the property."

Thus it was the propensity, rather than the intention or inevitability, for interest payable during a period of delayed completion to run on for more than a year which made it yearly interest, even though in many cases the delay in the completion of the purchase might well be much shorter.

23.
The potentially very wide interpretation of yearly interest in Bebb v Bunny was, in a series of later cases, significantly curtailed, albeit that in none of them was the decision held to have been wrong. On the contrary, it has remained the leading case. Goslings & Sharpe v Blake (1889) 23 QBD 324 was about a three months' bankers loan, repayable with interest on a fixed date, interest being calculated by reference to a rate per annum, an example of what Lindley LJ called, at p 330: "short loans by bankers". It establishes two principles relevant to the question whether interest is yearly interest (then within the meaning of section 40 of the Income Tax Act 1853). The first is that interest is not yearly interest merely because it is calculated by reference to a rate per annum: see per Lord Esher MR, at p 328. Secondly it establishes that the question whether the interest is "yearly" or "short" depends upon a business-like rather than dry legal assessment of its likely duration. At p 330, speaking of the mortgage example used in Bebb v Bunny, Lindley LJ said:

"The difficulty is not lessened by the circumstance that most mortgages are loans for six months. The ordinary form of mortgage contains a covenant to repay the loan in six months, and if not then paid a covenant to pay interest until the loan is repaid. Those are short loans; but in fact, as men of business, we know perfectly well that, except in exceptional cases, money lent on mortgages is very seldom repaid at the end of six months, the mortgagee usually being content with his security and receiving his interest half-yearly. … In point of business, therefore, a mortgage is not a short loan; but a banker's loan at three months is a totally different thing. That is a short loan, it is intended and understood to be a short loan, and the difference in practice between the two is perfectly well known to every business man."

24.
The first relevant case about whether statutory (rather than contractual) interest can be yearly interest is In re Cooper [1911] 2 KB 550, in which objection was taken to the supposed failure of a judgment creditor to deduct tax from statutory interest due on the judgment relied on in a bankruptcy notice served on the judgment debtor. That depended upon whether the interest was yearly interest.

In deciding that interest payable on a judgment debt under the Judgment Act was not yearly interest Cozens-Hardy MR said this, at p 553:

"The words 'yearly interest' are satisfied although the interest be not payable yearly but be payable quarterly or half-yearly, and further, as in the case of a mortgage, although the money is covenanted to be paid six months after date in the ordinary course of a mortgage, the court treats that as being a transaction to the knowledge and the reasonable intendment of all parties, upon which yearly interest was payable in the understanding and contemplation of all parties, it being really in the nature of an investment."(my emphasis)

25.
He continued:

"Now in the present case I ask myself is it possible to suppose that this was a transaction in which anybody contemplated or intended anything permanent? It is quite impossible so to regard it."

26.
At first blush, this decision of the Court of Appeal might appear to suggest that statutory interest could never be yearly interest because it arose otherwise than pursuant to any agreement, transaction or common intention of the parties. Subsequent cases have shown that this is not so but the concept of addressing the yearly interest question by reference to a perception whether the source of the interest can properly be regarded as a form of investment has survived. A negative answer to that question in relation to statutory interest from a surplus in administration formed a major plank in the administrators' submissions.

27.
A question deliberately left open in the Goslings case was whether interest on a short loan could nonetheless become yearly interest if the loan was left outstanding for more than a year. In Gateshead Corpn v Lumsden [1914] 2 KB 883 the plaintiff local authority had become entitled against the owners (including the defendant) of premises fronting a street which it had paved and made up, to a proportion of its costs, plus interest at 5% per annum. Although the Corporation had no settled practice of allowing these statutory debts to remain outstanding for periods of more than a year, it did so in relation to the defendant, who made payments on account of interest and capital from time to time. The Court of Appeal rejected a submission that the Corporation's forbearance converted interest into yearly interest within the meaning of section 40 of the 1853 Act. Applying the principle which he extracted from In re Cooper, Lord Sumner said, at pp 889-890:

"… applying the principle underlying that decision, I am unable to see how the words 'yearly interest' can apply to this transaction. There is no agreement for a short loan or a long loan. The debt is due and repayment is not enforced; only in that sense is there a loan. Truly speaking there is simply a forbearance to put in suit the remedy for a debt. The repayment might have been enforced at any moment. The debt might have been paid by the debtor at any moment."

Lord Sumner was careful to put on one side any case in which it might be established that the local authority had a settled practice of leaving statutory debts for street improvements outstanding for substantial periods of time. But the decision is good authority for the proposition that mere forbearance by a creditor who is entitled to statutory interest on a debt which is immediately due and payable does not bring that statutory interest within the confines of yearly interest. It serves as a caution against treating the words of Sir William Page Wood V-C in Bebb v Bunny (quoted above) as

meaning that the mere possibility that a stream of interest may endure for more than a year is sufficient in all cases to make it yearly interest.

28.
The investment test first enunciated in In re Cooper gains force from the analysis of Rowlatt J in Garston Overseers v Carlisle [1915] 3 KB 381. Persons claiming to be charitable trustees enjoyed a long-standing arrangement with their bankers whereby credits on current accounts generated interest. The question was whether that was yearly interest within section 105 of the Income Tax Act 1842, qualifying for deduction at source. By concession, that phrase in section 105 was treated as having the same meaning as in section 40 of the Income Tax Act 1853. Referring to the case law on section 40, Rowlatt J said this, at p 386:

"The broad result of the decisions in those cases is, I think, that yearly interest means, substantially, interest irrespective of the precise time in which it is collected, interest on sums which are outstanding by way of investment as opposed to short loans or as opposed to moneys presently payable and held over or anything of that kind."

29.
He continued, at p 387:

"They (the overseers) are to levy rates as far as they can for their current expenditure. However, they must necessarily keep a small balance in hand, and they get interest upon it under the arrangements which the bank were willing to make. It is no doubt contemplated that the balance will continue for a long time; but what is the daily balance? It is not even a short loan; it is merely money at call, money payable on demand."

Since those temporary balances could not be described as investments, the interest payable was not yearly interest.

30.
An attempt to reduce this jurisprudence to a concrete set of useful propositions was made by Lord Anderson, sitting in the Inner House (Second Division) of the Court of Session in Inland Revenue Comrs v Hay (1924) VIII TC 636 at 646. The case was about yearly interest within the meaning of section 27(1)(b) of the Income Tax Act 1918, but it was, again, common ground that the phrase had the same meaning as was under consideration in all the earlier cases, beginning with Bebb v Bunny. Lord Anderson said this:

"Now the authorities referred to by Crown Counsel seem to me to establish these propositions, five in number: - (First), that interest payable in respect of a short loan is not yearly interest (Goslings …). … (Second) that in order that interest payable may be held to be yearly interest in the sense of the Income Tax Acts, the loan in respect of which interest is paid must have a measure of permanence. (Third), that the loan must be of the nature - and this is pretty well expressing the second proposition in another form - that the loan must be of the nature of an investment (Garston Overseers). (Fourth), That the loan must not be one repayable on demand (Gateshead Corpn …). And (fifth) that the loan must have a 'tract of future time' (per Lord Johnston in Scottish North American Trust Ltd, 1910 Session Cases 966, 973). These propositions are perhaps one proposition expressed in different forms, but they are the result of the authorities."

I will refer these tests as "the Hay tests".

31.

Some further support for the pre-eminence of the investment test is to be found in the judgment of Lord Denning MR in Corinthian Securities Ltd v Cato [1970] 1 QB 377, at 382-383. After referring to Inland Revenue Comrs v Hay, he continued:

"The words 'short loan' are not used in the statute: it is a mistake to place too much emphasis on them. The real question is whether the interest payable is 'yearly interest of money'. Interest is 'yearly interest of money' whenever it is paid on a loan which is in the nature of an investment no matter whether it is repayable on demand or not."

After reviewing the Goslings case he continued:

"Looking at the agreement in this case, it is plain to me that this loan was made as an investment. Although payable on demand, it was unlikely that any demand would be made so long as the interest payments were kept up. It was a loan on the security of property, indistinguishable in principle from an ordinary loan or mortgage. The interest was 'yearly interest of money'."

32.
Some cold water was cast upon the investment test by Sir John Donaldson MR in Cairns v MacDiarmid [1983] STC 178, at 181, as follows:

"It is well settled that the difference between what is annual and what is short interest depends on the intention of the parties. Thus interest payable on a mortgage providing for repayment of the money after six months, or indeed a shorter period, will still be annual interest if calculated at a yearly rate and if the intention of the parties is that it may have to be paid from year to year (Bebb v Bunny … Corinthian Securities Ltd v Cato …). I would personally wish to avoid the use of the term 'investment' as providing any sort of test in the context of whether interest is annual interest, notwithstanding its use in the latter case, because it is possible to have a short term and indeed a very short term investment, eg overnight deposits, and such an investment does not involve any annual interest, regardless of whether the interest is calculated at an annual rate."

33.
That was a case in which it had been found that the loan was never intended to last for more than a few days, although there was an entitlement to postpone repayment for two years. It had, as intended, been discharged within a week, by novation. In my view the difference in approach to the use of investment as a test between that case and those which preceded it has more to do with changes in what the financial world regards as an investment than with any change in the underlying tax law. I consider that the Hay tests remain the best convenient summary of the jurisprudence about the meaning of yearly interest, in the context of interest which accrues due over time, whether purely contractual or statutory in origin.

34.
I turn now to the second group of cases, all of which were concerned with interest payable after the event (and usually in one lump sum) as compensation for the payee being kept out of money or property during some earlier period. The common characteristic of these cases, shared with this case, is that the interest does not accrue due during the period in question. Rather, it is awarded after the period has ended, as compensation relating to that earlier period. Taking them chronologically, the first is Barlow v Inland Revenue Comrs (1937) 21 TC 354. In 1923 the appellant, who was a trustee of settlements in favour of his children, realised the trust investments and reinvested the proceeds in his own name in unauthorised securities which subsequently fell in value. Recognising that he acted in breach of trust, by a deed made in March 1930 he covenanted to pay his fellow trustees an amount

equivalent to the proceeds of the realisation in 1923, together with compound interest at 5% per annum from the date of realisation until 1 January 1930. Finlay J, on appeal from the Special Commissioners, held that the interest element in the lump sum agreed to be paid by the deed was yearly interest. Following Vyse v Foster (1872) LR 8 Ch App 309 and Inland Revenue Comrs v Barnato [1936] 2 All ER 1176, he held that where a trustee agrees to pay principal and interest in respect of his breach of trust in relation to a period in the past, the interest element is properly to be regarded as interest (rather than damages) because the beneficiary has a right to elect between interest and an account of profits in respect of the period during which the trust property was mis-applied. He held that it was yearly interest on the basis that it fell clearly within the definition as explained in Bebb v Bunny. Although he did not say so in terms, this must have been because of the lengthy period of over six years prior to the March 1930 deed in respect of which the trustee had been accountable.

35.
In the famous litigation known as Regal Hastings v Gulliver the House of Lords had, in an order made in February 1942 [1967] 2 AC 134; [1942] 1 All ER 378, found that the defendant directors were liable to account to their company for a profit made by them in 1935 from the use of information which they held as fiduciaries. Interest at 4% per annum was ordered to be paid from the dates in October and December 1935 when the defendants had made the relevant profits. In March 1942 the defendants paid what they regarded as owing to the company including interest, but they deducted income tax on the interest element. Cassels J held (1944) 24 ATC 297, that this was yearly interest, deductible either under rule 19 or under rule 21 of the 1918 Rules. Although rule 21 related to interest of all kinds, rule 19 related only to yearly interest. The outcome was therefore much the same as it had been in the Barlow case save that, whereas the trustee in that case had volunteered an account including interest to the beneficiary, the liability of the defendant trustees in Regal Hastings v Gulliver had only been ascertained, after lengthy litigation, in the House of Lords. It was sufficient for Cassels J's decision that the interest was yearly interest that it had been paid in respect of a period of accountability of some six and a half years, so that cases such as the Gosling case were plainly distinguishable.

36.
The next, and most important case, is Riches v Westminster Bank Ltd [1947] AC 390. Section 3(1) of the Law Reform (Miscellaneous Provisions) Act 1934 provides that:

"In any proceedings tried in any court of record for the recovery of any debt or damages, the court may, if it thinks fit, order that there shall be included in the sum for which judgment is given interest at such rate as it thinks fit on the whole or any part of the debt or damages for the whole or any part of the period between the date when the cause of action arose and the date of the judgment."

37.
This discretion applies, as Viscount Simon said at p 397, regardless whether there is or is not a contractual right to interest which underlies the cause of action. He said that:

"The added amount may be regarded as given to meet the injury suffered through not getting payment of the lump sum promptly, but that does not alter the fact that what is added is interest."

38.
At p 398 he addressed a submission to the effect that an order for interest under section 3 could not be interest within the meaning of the Income Tax Acts because the added sum only came into existence when the judgment was given and from that moment had no accretions under the order awarding it. Viscount Simon said:

“But I see no reason why, when the judge orders payment of interest from a past date on the amount of the main sum awarded (or on a part of it) this supplemental payment, the size of which grows from day to day by taking a fraction of so much per cent per annum of the amount on which interest is ordered, and by the payment of which further growth is stopped, should not be treated as interest attracting income tax. It is not capital. It is rather the accumulated fruit of a tree which the tree produces regularly until payment.”

39.
Addressing the submission that the payment under section 3 was, however described, in truth damages, Lord Wright said, at pp 399-400:

“The appellant’s contention is in any case artificial and is in my opinion erroneous because the essence of interest is that it is a payment which becomes due because the creditor has not had his money at the due date. It may be regarded either as representing the profit he might have made if he had had the use of the money, or conversely the loss he suffered because he had not that use. The general idea is that he is entitled to compensation for the deprivation.”

40.
Later, at p 403, he said:

“It was said that the sum in question could not be interest at all because interest implies a recurrence of periodical accretions, whereas this sum came to existence uno flatu by the judgment of the court and was fixed once for all. But in truth it represented the total of the periodical accretions of interest during the whole time in which payment of the debt was withheld. The sum awarded was the summation of the total of all the recurring interest items.”

41.
Lord Simonds addressed the same submission at p 410 as follows:

“It was further urged on behalf of the appellant that the interest ordered to be paid to him was not ‘interest of money’ for the purpose of tax because it had no existence until it was awarded and did not have the quality of being recurrent or being capable of recurrence. This argument was founded on certain observations of Lord Maugham in Moss Empires Ltd v Inland Revenue Comrs [1937] AC 785, 795, in regard to the meaning of the word ‘annual’. It would be sufficient to say that we are here dealing with words in the Income Tax Act which do not include either ‘annual’ or ‘yearly’, but in any case I do not understand why a sum which is calculated upon the footing that it accrues de die in diem has not the essential quality of recurrence in sufficient measure to bring it within the scope of income tax. It is surely irrelevant that the calculation begins on one day and ends on another. It is more important to bear in mind that it is income.”

42.
In 1947 the income tax treatment of interest was still subject to the dichotomy described in paras 14-15 above. Tax on interest of any kind had to be deducted at source if not wholly paid out of taxed income, pursuant to rule 21 of the 1918 Rules. By contrast, rule 19 permitted the deduction (and retention) of tax at source where yearly interest was paid wholly out of taxed income. The Riches case was about rule 21 rather than rule 19 but the interest awarded under section 3 of the 1934 Act represented interest from June 1936 until May 1943, being the period since the arising of the cause of action during which the plaintiff had been kept out of his money. As Patten LJ observed in the present case (at para 54, referring back to para 25), the passage in Lord Simonds’ speech quoted above suggests that he would have regarded the statutory interest awarded in that case as both interest and

yearly interest for the purposes of the Income Tax Acts. This is because he regarded the payment of a single lump sum by way of interest after the event, referable to an earlier period for which the claimant needed compensation for being kept out of his money, as having the requisite quality of recurrence. Recurrence over seven years is plainly sufficient for that purpose.

43.
Jefford v Gee [1970] 2 QB 130 was another case about an award of interest under section 3 of the 1934 Act. The award was made in June 1969 by way of addition to damages for personal injuries incurred by the plaintiff in a motor accident in November 1966. It therefore compensated the claimant for having been kept out of his money for some two and a half years. At p 146, addressing the principles applicable to an award of interest in personal injury cases under section 3 of the 1934 Act, Lord Denning MR said:

“Interest should not be awarded as compensation for the damage done. It should only be awarded to a plaintiff for being kept out of money which ought to have been paid to him.”

44.
Later, under the heading Tax, at p 149, he continued:

“When the court awards interest on debt or damages for two, three or four years, the interest is subject to tax because it is ‘yearly interest of money’: see Riches v Westminster Bank [1947] AC 390.”

45.
It has been suggested (for example by Hildyard J at para 71(2) of his judgment) that Lord Denning MR may have failed to appreciate that the Riches case was about “interest” rather than “yearly interest”. In my view this ignores Lord Denning MR’s reference to the period of “two, three or four years” in respect of which interest is awarded. He was entitled to conclude that, even if the Riches case only established that the relevant payments were interest for tax purposes, they were nonetheless yearly interest because of the historical period of several years in respect of which the lump sum award of interest was made.

46.
Chevron Petroleum (UK) Ltd v BP Petroleum Development Ltd [1981] STC 689 is about the interest element in rolled-up payments by way of contribution to expenses in a joint venture agreement for the exploitation of the Ninian oilfield in the North Sea. The participants made payments against the expenditure in accordance with their expected share of the production. Provision was made for each participating group’s share to be adjusted in the light of later experience of actual production. After an accounting which added interest to the amounts expended, the participants were credited or debited with the differences between their contributions on account and their adjusted contribution liability. Thus the liability to make payments against debits was contingent upon share adjustments pending final calculations, and the interest element in them related to periods of time which had passed before any payment liability fell due. Nonetheless Sir Robert Megarry V-C held that the interest element was yearly interest, and therefore subject to deduction at source. He said, at p 696:

“I cannot see why the contingency should deprive the so-called ‘interest’ of the quality of being true interest. If X lends £100 to Y, the loan to carry interest at 10% per annum, why should a provision for repayment and interest to be waived in certain events, or for repayment with interest to be made only in certain events, prevent the interest from being true interest if in the event it becomes payable?”

Later, at pp 696-697, commenting upon the Riches case and interest awarded under section 3 of the 1934 Act, he continued:

“Although the obligation to pay interest was created by the judgment, the award was made on the basis that the defendant ought to have paid the money sued for at an earlier date and had not done so. The interest awarded was interest in respect of the plaintiff having been wrongfully kept out of the money: ... That was not so in the present case, where the operating parties had duly paid all that was due from them under the contract at the time when it was due.

I do not think that this point, or, indeed, any other point, suffices to distinguish the Riches case. If a contract (eg with a builder) provides for specified payments to be made on account of the final liability, and for interest at a specified rate to be paid on any balance when the final accounts have been agreed, the fact that all the specified payments on account were punctually made does not, it seems to me, prevent the interest payable on the balance from being truly ‘interest’.”

Analysis

47.
The statutory interest in the present case shares many of the relevant features with the contractual provision for interest in the Chevron case. In both cases it cannot be known during the period in respect of which interest is calculated whether it will in fact be payable at all. In the Chevron case liability depended upon an adjustment of participants’ shares made in the light of actual production, after the relevant expenditure was incurred, which increased rather than reduced the relevant participant’s share of the liability to fund expenses. In this case it depends upon the realisation of a surplus after payment of proving creditors’ claims in full, necessarily after the commencement of the administration and indeed after the end of the period in respect of which interest is calculated, which ends upon payment of the creditors’ debts. In both cases there is no liability to pay interest during the period in respect of which it is calculated. In both cases the interest is not itself payable over a period of time. It is rolled up and payable in a single lump sum. In short the interest is not an income stream, payable over a period of a year or more, but it is nonetheless income rather than capital, as the Vice Chancellor was at pains to emphasise, at p 696.

48.
More generally the relevant features of the interest in this case have much more in common with the second group of cases about statutory interest under section 3 of the 1934 Act, and about interest ordered or agreed to be paid by a trustee or fiduciary in respect of a past loss or misapplication of trust property than they have with the first group of cases about interest accruing due and payable immediately, or over time, beginning with Bebb v Bunny. This is not because the interest is statutory rather than contractual. There are examples of each in both groups. It is first because in none of the second group is the interest actually due and payable during the period by reference to which it is calculated, nor can it be said with certainty during that period that it ever will become due. But the interest is nonetheless payable, after the event, as a form of compensation for the recipients being in some way out of their money during the period in respect of which it is calculated. In the cases about interest under the 1934 Act the recipients are (usually) compensated for that loss during the period when they have a cause of action for debt or damages, until a judgment gives them an enforceable right to payment. In the trust cases the beneficiary is compensated by payment of interest for the loss (if any) represented or caused by the trust fund being out of the monetary value of the trust property lost or misappropriated by the trustee, until the trustee accounts and pays that sum back into the trust fund. In the Chevron case the payment of interest by the participants who later incurred an

increased contribution share compensated those participants who, in the light of production experience, turned out to have paid more than their fair share of the cost of generating it.

49.

In the present case, as Mr Goldberg was at pains to emphasise, it cannot generally be said from the commencement of an administration whether there will ever be generated a surplus out of which statutory interest will become payable. Such surpluses are in fact very rare indeed. It may be that, during that period, the process of asset recovery by the administrators will make a surplus more likely, but even then its amount and the timing of any interest payment will all depend upon countless contingencies, including (in this case) long drawn out litigation about the amount of creditors' claims. Statutory interest is never due until after all proving creditors have been paid in full. There is always a risk that an administration will be followed by a winding up, with unfortunate (and probably unforeseen) consequences upon the availability of interest under rule 14.23, even if there is a surplus: see In re Lehman Brothers International (Europe) (in administration) (No 4) [2018] AC 465 per Lord Neuberger of Abbotsbury, at paras 117 to 121. Nonetheless, as rule 14.23 makes clear in the plainest terms, the interest once paid compensates proving creditors for being kept out of their proved debts from the commencement of the administration (which prevents them seeking any other form of recovery), until they are actually paid.

50.

Mr Goldberg sought to distinguish the trust cases on the basis that, pursuant to Vyse v Foster, a beneficiary had an enforceable right to interest from the moment when the trust property was lost or misapplied. For the reasons given by Patten LJ in the Court of Appeal, at paras 45 to 50, based upon Target Holdings Ltd v Redferns [1996] AC 421, this is not the correct analysis of the basis upon which the court awards interest in equity. It is discretionary, like interest under the 1934 Act, even though the discretion may be exercisable in accordance with well-settled principles.

51.

It is true, as the administrators submitted, that some of the second group of cases were primarily concerned with the question whether payments described as interest were truly interest at all for income tax purposes, rather than whether they were yearly interest. In the Riches case this was because the question arose under a provision in the 1918 Rules relating to all types of interest. In Jefford v Gee it may be that Lord Denning MR was not overly concerned with whether the interest was yearly or not, although he certainly took notice of the fact that the plaintiff had been out of his money for several years. In the Chevron case the contrary argument was that the element in the rolled-up payment described as interest was not interest at all. There may have been no dispute that, if it was, it was yearly interest. By contrast in the present case it has been common ground throughout that statutory interest under rule 14.23 is interest for the purposes of income tax.

52.

But those cases nonetheless provide the answer to the conundrum: what period of durability is to be identified for interest payable in a single lump sum as compensation for the payee being out of the money in the past, for the purpose of deciding whether it is to be treated as yearly interest, under the Hay principles? The simple answer, supplied by all the second group of cases, is that it is the period in respect of which the interest is calculated, because that is the period during which the loss of the use of money or property has been incurred, for which the interest is to be compensation.

53.

This appears also to have been the assumption made by the drafter of what is now section 874(5A), quoted above. It deems payment of interest to an individual in respect of compensation to be yearly interest “irrespective of the period in respect of which the interest is paid”. This suggests that, but for the deeming provision (introduced, so the court was told, to deal with compensation for mis-selling of Payment Protection Insurance), the question whether the interest would or would not have been yearly interest would have depended upon the duration of the period in respect of which the compensatory interest was calculated.

54.
It may of course be said that this approach has nothing to do with the intentions of the payer and the payee, and that, for most of the relevant period it will not be known when it will end, or whether interest as compensation for that loss will ever be paid. This is true of all the second group of cases, just as in the present case. But this gives rise to no relevant uncertainty. The payer will always know what that period is by the time that the interest becomes due and will be able to deduct tax or pay gross accordingly. In the case of interest under the 1934 Act the judge is required to identify the period. In the trust cases the order for payment of interest will also be by reference to a defined period. In the present case the period is fixed by the date of commencement of the administration and the date (or dates) upon which the proving creditors are paid their debts.

55.
I must finally address the group of submissions deployed by the administrators under the heading “source”. These were not deployed with any prominence in, or at least addressed by, the Court of Appeal, but they were advanced at the forefront of Mr Goldberg’s submissions in this court. The argument goes like this. Income Tax is, and always has been, levied by reference to the source of the relevant income. The only source from which interest under rule 14.23 can be said to derive, apart from the statutory provision itself, is the combination of a realised surplus and a decision by the administrators that it is time to pay it. Those elements cannot, either singly or together, be said to have the quality of durability over time sufficient to make the interest yearly interest for income tax purposes, applying the Hay tests. They are unpredictable, liable to evaporate in the event of a winding up, will generally not have existed for a year before payment, and cannot be regarded as being in the nature of an investment. The period of time in respect of which the statutory interest is calculated cannot itself be regarded as a source of the interest. If there has to be a search for any source of the statutory interest other than the surplus and the decision to pay, it can only be the contractual debts owed by LBIE to its creditors at the moment when it went into administration, but those debts were mainly short term in nature, lacking the requisite capacity to generate yearly interest. Furthermore for income to be taxable at all the source has to be in existence at the time when the income becomes due and payable. Neither those contractual debts, nor the provable debts which replaced them from the commencement of the administration, remained in existence when the statutory interest became payable. They had all by then been discharged by payment in full.

56.
The short answer to this submission is that, if it were correct, all the second group of cases would have been wrongly decided. In none of them did the interest under review have a source in the sense of some kind of durable investment. In the equity cases the beneficiaries received interest by way of compensation for part of their trust fund being lost or misappropriated. In the cases under the 1934 Act the plaintiffs were being compensated for the delayed payment of damages, in one case for the pain and suffering occasioned by a broken leg which had no doubt healed long before the interest

became due. In the Chevron case one group of joint venturers were in substance being compensated, long after the event, for having contributed more than their fair share of the expenses.

57.
But the flaws in the submission are more fundamental than that. First, the obligation to deduct tax from interest under section 874 does not depend at all upon the question whether the interest is taxable in the hands of the recipient. If the payment is yearly interest, and the payers (or the circumstances) qualify, for example because the payer is a company, or the usual place of abode of the recipient is offshore, then tax must be deducted. There is no requirement to identify a source at all, in the case of statutory or other UK interest. At the most it may be said that the first group of cases can loosely be characterised as involving an examination of the source of the interest as part of the inquiry about whether the income in question was "yearly interest of money".

58.
Secondly, it is artificial to regard the source of statutory interest as having anything to do with the realisation of the surplus, still less the decision of the administrators to pay it, even though the combination of those two factors may be said to have been the immediate cause of the interest becoming payable. Of course the interest may be said to derive from the surplus, in the sense of constituting the fund from which it came, but the concept of source in that literal sense had nothing whatever to do with the characterisation of the payments as yearly interest in any of the second group of cases or, for that matter, even in the first group. As for the decision of the administrators to pay, this broadly equates with the exercise of a judicial discretion, both in the equity cases and those under the 1934 Act. To the limited extent that it may be said to render the right to payment contingent, it is a much less formidable contingency than the exercise of judicial discretion. In truth the administrators have no real discretion at all.

59.
Thirdly, to the extent that it is instructive to look for a source of the statutory interest under rule 14.23, the obvious candidate is the status of the recipient as a proving creditor during the period between the commencement of the administration until payment of the principal amount by dividend. That is a statutory status created by the insolvency code laid down by the Insolvency Act and Rules, which (as we now know) replaces the creditor's former contractual rights at the commencement of the administration. It precisely coincides with the period in respect of which the statutory interest is calculated and, for the reasons given above, amply fulfils the necessary quality of durability over time.

60.
Finally, if it were necessary to do so, I would regard the status of a proving creditor in a distributing administration as having the requisite character of being an investor, albeit an unwilling and involuntary one. It is no mere irony that LBIE's unsecured debt has, during that last ten years, turned out to be a very satisfactory long-term investment, generating interest, payable in full, at a handsome 8%.

61.
For all those reasons, which do not differ in their essentials from those given by Patten LJ in the Court of Appeal, I would dismiss this appeal.