Withholding Tax Exemption – Private Placements

The Government announced a new withholding tax exemption for privately placed debt issuances in this year's Autumn Statement. Draft legislation has now been published – we look at the implications of the proposed exemption, and ask whether the conditions are likely to prove workable in practice.

Why a new exemption is needed

Interest paid by UK companies is generally subject to withholding at 20%.

There are exemptions for interest paid to UK banks and UK companies, and interest paid on securities listed on a "recognised stock exchange" (the "quoted Eurobond" exemption).

These exemptions are of limited use to the private placement market, given that private placements are typically not listed, and investors are often institutions based outside the UK.

Such investors may be resident in jurisdictions that have a tax treaty with the UK that provides for exemption from withholding tax. However, claiming withholding tax exemption under a treaty involves a somewhat slow and cumbersome procedure (which is particularly hard to operate if privately placed notes are tradeable).

There has recently been a great deal of political and regulatory interest in expanding the private placement market, driven in large part by a desire to provide businesses with an alternative source of funding given that banks' balance sheets are constrained by new regulatory capital requirements.

This has led many to ask the Government to create a specific withholding tax exemption that puts foreign institutional investors on a par with UK investors and foreign holders of listed debt.

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The new legislation

The Chancellor announced in this year's Autumn Statement that a new exemption would be enacted "to help unlock new finance for businesses and infrastructure projects" and this has been welcomed by institutional investors and others.

Draft legislation and a technical note have now been published for consultation.

The conditions set out in the draft legislation are as follows:

- a security is issued by a company;
- the security is a "loan relationship" of the company for corporation tax purposes (which will in practice usually be the case);
- the security will be issued for a period of at least three years; and
- the security is not listed on a recognised stock exchange (i.e. the "quoted Eurobond" exemption does not apply).

Additional conditions will be set out in draft regulations. The technical note outlines proposed content for those regulations and invites comment.

The proposed additional conditions are:

The issuer must:

- be a trading company (and not an SPV); and
- issue securities of a specified minimum and maximum aggregate amount (with £10m to £300m proposed);

A holder of the security must:

- have no connection to the issuer;
- be a UK regulated financial institution or an equivalent entity authorised outside the UK carrying on a substantially similar business;
- be resident in a "qualifying territory" (broadly jurisdictions with which the UK has a proper tax treaty – no tax havens);
- be the ultimate beneficiary and not a mere intermediary for other persons (or passing the benefit to other persons by a chain of loans); and
- certify its qualification at the outset and periodically thereafter.

The security must:

- have a maturity of between 3 and 30 years;
- pay interest at a normal commercial rate;
- not be convertible into shares;
- be unsubordinated to existing unsecured indebtedness of the issuer; and
- be issued in a minimum denomination of £100,000.

Finally, the exemption will not apply where the security is not issued and held for genuine commercial reasons or if it is held as part of a "tax advantage" scheme.

Our response

We welcome the new exemption, and expect it will benefit both issuers and institutional investors.

Furthermore, there should be only a limited cost to the Revenue - the exemption will in most cases merely save investors from having to make treaty claims (rather than change the amount of UK tax they fundamentally pay).

That broad welcome aside, a few of the proposed conditions seem to us unnecessarily restrictive:

- it would be helpful to clarify if the exemption is to apply to loans. It is not clear to us that there is a policy rationale for treating bonds more favourably than loans;
- there may be non-corporate issuers who wish to take advantage of the exemption (e.g. local authorities) – at present they are excluded;
- it is understandable that HMRC wish to limit the exclusion to issuers that are carrying on a trade. However, there are a number of non-tax reasons why corporate issuers cannot issue directly and so need to establish SPV issuers whose debt obligations they guarantee. For example, an issuer that is a private limited company may be concerned that the private placement could constitute a public offer of securities and so breach the Companies Act. Alternatively, there

may be potential structural and rating benefits which flow from the establishment of a "bankruptcy remote" issuing vehicle;

- it would be helpful to clarify that the exclusion for intermediaries will not prevent funds from taking advantage of the exemption;
- the requirement that holders be subject to regulatory authorisation may in practice exclude a significant proportion of the market, as there are many institutional investors that are not required to be regulated (e.g. sovereign wealth funds and unregulated funds);
- the £300m limit is likely too low – also, query if it applies to all securities an issuer has outstanding, or individually to each issuance; and
- the minimum issue size of £10m seems to us too high if the intention is to facilitate competitive financing for medium-sized businesses - £1m would be preferable.

We will be discussing these points with industry bodies and market participants.

Timetable

The draft legislation and proposed conditions can be found here. Responses to the consultation are requested by 27 February 2015.

The new exemption is then expected to be included in the Finance Bill 2015 and to take effect on or after the date of Royal Assent to the Finance Bill 2015 (likely late July 2015).

Further information

If you would like further details on any aspect of the proposed new exemption, or how it applies to your institution or transactions, please speak to your usual Clifford Chance contact or any of those listed on the first page.

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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