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Briefing note March 2015

Withholding Tax Exemption – Private Placements

Further to the Government's announcement in last year's Autumn Statement that it intended to introduce a new withholding tax exemption for privately placed debt, legislation has been included in this year's Finance Bill. We consider how the legislation has developed since the draft published in December 2014 and consider the potential impact of the new exemption.

Background to the new exemption

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, since private placements are typically not listed, and investors are often institutions based outside the UK.

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 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 now that banks' balance sheets are constrained by new regulatory capital requirements.

This led to an announcement in last year's Autumn Statement that the Government intended to introduce a new specific exemption from UK withholding taxes on interest paid in respect of "qualifying private placements".

Key Contacts

David Bickerton
Regional Managing Partner, London
david.bickerton@cliffordchance.com

Steve Curtis
Partner
steve.curtis@cliffordchance.com

Chris Davies
Global Head of Tax
chris.davies@cliffordchance.com

Mark Huddlestone
Partner
mark.huddlestone@cliffordchance.com

Dan Neidle
Partner
dan.neidle@cliffordchance.com

Simon Sinclair
Partner
simon.sinclair@cliffordchance.com

Nicola Wherity
Partner
nicola.wherity@cliffordchance.com

The revised legislation

Draft legislation and a technical note were published in December 2014 for consultation.

The conditions set out in that draft legislation for a security to fall within the definition of a "qualifying private placement" were as follows:

- a security is issued by a company;
- the security is a "loan relationship" of the company for corporation tax purposes;
- the security will be issued for a period of at least three years;
- the security is not listed on a recognised stock exchange (i.e. the "quoted Eurobond" exemption does not apply); and
- other conditions to be set out in regulations are met.

The first and the third of these conditions have been removed in the revised legislation and we welcome this change.

The need for clarity as to whether the exemption will apply to loans is important. In our experience, private placement lenders wish to benefit from the flexibility to invest by way of either loans or notes and it is not clear to us that there is a policy reason to restrict the exemption to bonds. The redrafting of the legislation to remove the requirement that the security is issued by the company is helpful and is an indication that the term "security" will in practice cover loans as well as bonds.

In addition, it is not clear to us that there is a need for a minimum term (and, indeed any minimum term may be problematic depending on how it interacts with provisions permitting or requiring early repayment in certain circumstances which are commonly (if not universally) found in private placement documentation). The removal of the minimum term of three years from the primary legislation is therefore helpful; although it may be that conditions relating to the term of the security are introduced in regulations.

The potential impact of the new exemption

As with the previous draft of the legislation, reference is made to the fact that additional conditions will be set out in regulations (not yet available) and will need to be met for a security to constitute a 'qualifying private placement'.

While the simplification of the legislation and the removal of the two conditions discussed above are helpful, the true impact of the new exemption will only be fully understood once regulations setting out the additional conditions are published.

A list of some of the proposed additional conditions can be found in our earlier briefing paper - here. In summary, regulations are likely to include conditions relating to the security itself, both the debtor and the creditor of the loan relationship and, as a result of the revised legislation, any person by or through whom a payment of interest on the security is made.

The conditions which are likely to be of most importance to the Government, and therefore are likely to be included in the regulations, are that:

- a holder of the security must have no connection to the debtor; must be resident in a "qualifying territory" (broadly jurisdictions with which the UK has a proper tax treaty – no tax havens) and must certify its qualification; and
- the security is used to finance (directly or indirectly) a trading business.

It is hoped that a number of the conditions identified by us and others in the private placement market as unnecessarily restrictive will fall away following further public consultation. If this is the case, the exemption should be of wide benefit to both borrowers and institutional investors. In particular, the exemption will be beneficial for investors resident in countries where the treaty between the UK and their country of residence does not reduce withholding taxes on interest to zero (for example China, Hong-Kong and Korea).

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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Clifford Chance, 10 Upper Bank Street, London, E14 5JJ

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