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The new UK withholding tax exemption for private placements: how will it work in practice? And does it apply to the wider UK loan market?

The UK has a new withholding tax exemption for private placements, which came into force on 1 January 2016. On 5 April 2016 the LMA published updated private placement documentation facilitating the use of the exemption.

We look at how the exemption works, how the LMA documentation facilitates it, and whether the exemption has wider application to UK loans that are not private placements.

Why an exemption was needed

The UK generally imposes a 20% withholding tax on interest paid to non-residents. Whilst the UK has tax treaties with many jurisdictions, the procedural formalities to take advantage of the treaties are somewhat awkward. Furthermore, there are important jurisdictions where the UK's tax treaty reduces but does not eliminate the rate withholding tax (e.g. China).

These issues stood in the way of an expanded UK private placement market – particularly as most other European jurisdictions no longer impose withholding tax on interest.

Hence, given the political and regulatory interest in the private placement market, last year HM Treasury began to discuss with us, the LMA and others how a new withholding tax exemption could be introduced. The outcome of these discussions was the "qualifying private placement exemption" (the **QPP exemption**).

The QPP exemption came into force on 1 January 2016, but can apply to securities issued prior to that date.

For further background to the exemption please see our previous briefings here and here.

How the QPP exemption works

The duty to make a deduction of tax from UK interest payments does not apply to a payment of interest on a "qualifying private placement". A qualifying private placement is a "relevant security", i.e. a security or loan relationship to which a company is party as a debtor; is unlisted; and meets the conditions set out in the regulations.

The regulations set out a number of conditions relating to the creditor, the debtor and the security itself.

Conditions relating to the debt itself

- Under the legislation, the term "relevant security" includes a loan, and HMRC has confirmed to us that the debt instrument does not have to be in any particular form.
- The term of the security must not exceed 50 years.
- All securities comprising a single placement issued by the debtor must have an aggregate minimum value of £10 million at the time of issue.

Conditions relating to the creditor

The debtor must hold a "creditor certificate" in which the creditor confirms that:

- it is beneficially entitled to all interest payable to it under the security;
- it is beneficially entitled to such interest for genuine commercial reasons and not as part of a tax advantage scheme; and
- it is resident in a qualifying territory (i.e. broadly, the UK or a territory with which the UK has a double tax treaty including a non-discrimination article – so most non-tax haven jurisdictions).

We have worked with the LMA to devise a standard form of creditor certificate, which is incorporated into the LMA private placement documentation. A lender wishing to take advantage of the exemption simply indicates their intention to do so, and signs the creditor certificate scheduled to the document.

Conditions relating to the debtor

- The debtor must issue the security for genuine commercial reasons and not as part of a tax advantage scheme.
- The debtor must reasonably believe that the debtor and the creditor are not connected persons. Borrowers should pay particular attention to this condition if they are part of a wider corporate group that includes entities that could inadvertently acquire particip-ations in the debt.
- The debtor generally has to be a corporate entity, although where the debtor is a partnership with corporate members it is arguable that the exemption is still available.

If the conditions are satisfied, and a creditor certificate has been provided, a debtor can apply the exemption immediately to make interest payments to that creditor free from UK withholding tax.

What this means in practice for private placements

We expect the conditions noted above will in practice be satisfied for most UK private placements. Corporate investors in the US, Asia and Europe will generally be able to provide the creditor certificate.

For investors in jurisdictions like the US and France this represents a significant saving in the administration and risk associated with the historic UK treaty procedures.

For investors in jurisdictions like China and Korea, this represents a new opportunity to invest in unlisted UK debt free from withholding tax.

We therefore expect most non-UK investors to start using the QPP exemption, and providing creditor certificates, as a matter of course.

The main cases where the QPP exemption won't apply are:

- small issuances of below £10m;
- issuances by non-corporate entities such as partnerships and unit trusts;
- where an investor is resident in a tax haven such as the Cayman Islands or Jersey; and
- where private placement notes are cleared, as the borrower will find it difficult to rely on a creditor certificate when it does not know for certain who beneficially owns its notes.

> "This is, in our view, a very significant development for the syndicated loan market"

There is also an element of doubt as to whether the exemption can be used by tax transparent entities (such as partnerships) and SPVs such as CLOs. Updated guidance is expected from HMRC; until then, specific advice should be taken before seeking to rely on the QPP exemption.

What this means for the wider loan market

Although labelled the "qualifying private placements" exemption, the exemption is drafted very widely and should apply outside of the traditional "private placement" market.

HMRC have confirmed to us that the QPP exemption can, where the necessary conditions are met, be applied in the context of a syndicated loan.

Accordingly, the LMA will shortly be including QPP exemption wording in its standard form investment grade and leveraged loan agreements.

This is, in our view, a very significant development for the syndicated loan market. It will eliminate the cumbersome treaty procedures, which often cause frictional cost and, when they go wrong, not uncommonly lead to disputes. More importantly, it will open up the UK syndicated loan market to lenders, particularly in Asia, who have not historically been able to participate without suffering withholding tax.

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 opposite.

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