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Briefing note

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HMRC Double Taxation Treaty Passport Scheme: what the 2017 changes mean for borrowers, lenders and the UK loan market

The Double Taxation Treaty Passport (DTTP) Scheme is critical for funds and other non-UK lenders active in the UK loan market.

However, the DTTP Scheme has historically only applied where borrower and lender are both corporate entities. Following a recent consultation, these limitations are being mostly removed. This briefing considers the practical implications.

Why is the DTTP Scheme important?

Most European jurisdictions no longer impose withholding tax on interest paid on commercial loans. The UK unfortunately still does.

Borrowers in the UK are required to withhold income tax at 20% from interest paid to foreign lenders. Such lenders will often benefit from tax treaties with the UK which eliminate interest withholding. But a lender must obtain a treaty clearance to access a treaty – and until it has done so, the borrower must withhold tax at 20%. So if a lender is to avoid receiving net payment, it will want to obtain treaty clearance as quickly as possible.

What is the DTTP Scheme?

The DTTP Scheme was originally introduced in September 2010 to simplify the procedure for obtaining treaty clearance.

Prior to the introduction of the DTTP Scheme, the only way to obtain a direction was for the overseas lender to obtain a residence certificate from its home tax authority, and submit this and an application to HMRC. This had to be repeated for each loan the lender made, with a potential delay of months (and in some cases years) before HMRC would accept the application and grant the treaty clearance.

The DTTP Scheme streamlines the process of obtaining a direction by allowing overseas lenders to apply for a "treaty passport".

Once a lender has a passport, it simply provides the passport details to a UK borrower when it makes a loan. The borrower then electronically notifies HMRC, and treaty clearance usually follows within 30 days.

The DTTP Scheme has proved to be very popular and around 3,000 passports have been issued in the five years since it was introduced.

What were the limitations of the DTTP Scheme?

The main limitation with the DTTP Scheme as originally implemented was that it only applied to corporate-to-corporate lending.

It is common in some sectors,

such as real estate, to see unit trusts or partnerships as borrowers. These entities were excluded from the DTTP Scheme. That made it more onerous (and sometimes expensive) for foreign lenders to lend to such borrowers.

The restriction on non-corporate entities also applied to lenders. Hence a lender structured as a partnership was unable to obtain a treaty passport – even if all of its partners were themselves eligible for treaty relief.

Other non-corporates were also excluded so, to take two particularly significant examples, pension funds and sovereign wealth funds were unable to obtain treaty passports. This was often seen as anti-competitive – it is unclear why (say) a Canadian pension fund creates greater tax risk for HMRC than a European debt fund.

What changes have been made to the DTTP Scheme?

Following a recent consultation, HMRC has expanded the scope of the DTTP Scheme.

First, **all** borrowers making UK source payments will be able to use the DTTP Scheme. Unit trusts and partnerships will now be able to access the treaty passport Scheme in the same way as any other borrower.

The DTTP Scheme is also now open to other non-corporate entities, such as individuals and charities.

Second, transparent entities (e.g. partnerships), sovereign wealth funds and pension funds will be able to register for treaty passports.

In the case of transparent entities, all members beneficially entitled to the interest must be resident in the **same** jurisdiction and be entitled to the **same** benefits under the relevant treaty. Hence in practice only funds/partnerships with relatively static memberships will be able to apply for a treaty passport.

HMRC rejected extending the DTTP Scheme to sovereign immunity (as opposed to a sovereign wealth fund benefiting from a tax treaty exemption). Such lenders will need to continue to use the "certified claim" method.

When will the changes take effect?

HMRC published the updated terms and conditions of the DTTP Scheme on 6 April 2017 and the changes have effect from this date.

Loans entered into between 1 September 2010 and 5 April 2017 will still be subject to the old terms and conditions of the DTTP Scheme. This means that overseas lenders who advanced loans to non-corporate UK borrowers before 6 April 2017 must continue to use the "certified claim" method.

However, if a loan was advanced before 6 April 2017 but is subsequently sold or assigned, HMRC will treat the date of sale or assignment as being the date the loan commenced, such that the updated terms and conditions will apply to that lender in respect of the loan.

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