Client Alert

24 December 2015

The Private Placements Withholding Tax Exemption

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The Finance Act 2015 introduced an exemption from a borrower's obligation to withhold tax from interest payments arising on qualifying private placements. It was introduced to stimulate and grow the private placements market in the UK in order to unlock a new source of financing for mid-sized borrowers. Following a consultation period, the Qualifying Private Placement Regulations 2015 were made on 9 December 2015 and the exemption is set to enter into force on 1 January 2016.

THE CURRENT POSITION

The UK imposes a 20% withholding on payments of interest by UK incorporated companies to foreign entities on loans and debt securities where the loan or debt is intended to last more than a year. Lenders resident in jurisdictions that have entered into a double tax treaty with the UK that reduces withholding tax to zero may generally apply to HMRC for zero withholding, either by submitting an application for formal tax treaty clearance or via the double tax treaty passport system.

From 1 January 2016, this process will be significantly simplified once the Regulations come into force.

CONDITIONS THAT MUST BE SATISFIED FOR THE EXEMPTION TO APPLY

The initial gateway conditions

In order to qualify for the exemption, the private placement must broadly comprise of a security which: (i) represents a debtor loan relationship of a company; (ii) is not listed on a recognised stock exchange; and (iii) meets the additional conditions specified in the Regulations.

Additional conditions

The Regulations specify that the following further conditions must be met in relation to the security:

1. the term of the security must not exceed 50 years (note that there is no minimum term specified);
2. at the time the security was entered into, it must either have had a minimum value of £10 million or, where a single placement comprises more than one security, the placement must have had a minimum value of £10 million (note that there is no upper limit); and
3. the borrower must hold a "creditor certificate" which has not been withdrawn by the creditor or cancelled by HMRC.

THE CREDITOR CERTIFICATE

The creditor certificate is a written statement provided by (or on behalf of) the lender which confirms that the lender is: (i) a resident of a qualifying territory; and (ii) beneficially entitled to interest on the security for genuine commercial reasons and not part of a tax scheme. The Regulations provide that HMRC is entitled to require a borrower to produce a creditor certificate upon request.

In order to be considered a qualifying territory, the territory in question must be a party to a double tax treaty with the UK that includes a non-discrimination article. A non-discrimination article is a clause within the treaty the purpose of which is to prevent one party state subjecting the national of the other party state to any taxation or connected procedures that are additional to or more burdensome than those to which it subjects its own nationals. Note that the exemption will still apply even where the treaty does not reduce the rate of withholding to nil.

PRACTICAL IMPLICATIONS

We have been in discussion with HMRC and have been advised that the responsible team are in the process of reviewing the Regulations and expect to publish guidance in its Savings and Investment Manual shortly. In the meantime, we would expect that, from the New Year when the Regulations come into force, a borrower will be entitled to pay gross interest to lenders without the need to obtain preclearance or a direction from HMRC in the majority of cases, so long as it is in possession of a valid creditor certificate. In practice, borrowers should ensure that new language is included within the relevant security documentation so that the borrower is able to obtain the necessary creditor certificate. Should a lender prove ineligible or is otherwise unwilling to provide the borrower with a creditor certificate, the borrower should ensure that it is under no obligation to gross up its interest payments whilst also accounting to HMRC for any interest withheld.

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