CLIENT MEMORANDUM

United Kingdom – New Rules and Procedures for Interest Withholding Tax

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In welcome news for the UK market, HM Revenue & Customs (**HMRC**) has expanded the scope of its Double Tax Treaty Passport Scheme (**DTTP Scheme**). The revised DTTP Scheme will enable a wider range of UK borrowers and foreign lenders to access the simplified administrative procedure for claiming reduced rates of interest withholding tax under a double tax treaty. In addition, the UK Government has launched a consultation on a new exemption for debt traded on Multilateral Trading Facilities (**MTFs**), which would essentially expand the existing 'quoted Eurobond' exemption for exchange-listed debt to debt traded on other platforms.

Background of DTTP Scheme

The UK does not allow self-assessment of entitlement to claim treaty benefits.

In the context of loans from foreign lenders to UK borrowers, where UK income tax is, in principle, required to be withheld from payments of interest, lenders are ordinarily required to file a separate application with HMRC, in respect of each loan, to claim a reduced rate of UK withholding tax under a treaty between the UK and the lender's country of residence. The application is first sent to the relevant overseas revenue authority to obtain certification that the particular lender is resident in that country and entitled to the benefit of the treaty. Secondly, HMRC will assess the application and, if satisfied that all other treaty conditions are met, give a direction to the UK borrower to pay interest gross. This two-step procedure takes several months.

To reduce the administrative burden this places on lenders that frequently lend into the UK, HMRC introduced the DTTP Scheme in September 2010 whereby lenders can apply for a 'passport' (which is valid for five years), replacing the first step of the application process (that is, confirming entitlement to treaty benefits as a resident of the relevant treaty country). Borrowers that have received the relevant lender's consent to use the lender's passport reference number will request a direction from HMRC to pay interest gross on the loan in question. HMRC generally provides a response within 30 working days.

The DTTP Scheme was previously only available in respect of corporate-to-corporate lending.

DTTP Scheme to Apply to Wider Range of Borrowers and Lenders

Following a consultation, the UK Government announced that the DTTP Scheme would be made available to a wider range of borrowers and lenders. HMRC Guidance was published on April 6, 2017 confirming the expanded scope of the DTTP Scheme.

For loans entered into on or after April 6, 2017, all UK resident borrowers, including UK partnerships, individuals and charities, may access the DTTP Scheme.

Lenders that are partnerships, sovereign wealth funds and pension funds may now apply for a passport, but only where all of the ultimate beneficial owners of the income under the loan are entitled to the *same* treaty benefits under the *same* treaty.

This restriction was widely criticised by respondents to the consultation on the basis that it would exclude most partnerships from accessing the DTTP Scheme. However, the Government took the view that this was the only way of ensuring the DTTP Scheme remained relatively easy to administer. There was no consensus as to how a scheme available to partnerships with partners resident in multiple jurisdictions could work. Suggestions included applying different rates of withholding tax on different portions of the loan, or applying a blended rate of withholding tax which the partnership would allocate to its members according to their entitlement. Any of these methods would add complexity to the arrangements. Suggestions also included extending the DTTP Scheme to partnerships where all partners were entitled to the same treaty benefits but under different treaties. However, it was acknowledged that a requirement for all partners to have the same treaty benefits would make it almost as difficult to admit new partners to a partnership as a requirement for all partners to be resident in the same jurisdiction.

Consultation on Expanding the Quoted Eurobond Exemption

There is no UK withholding tax on payments of interest in respect of 'quoted Eurobonds'. These are interest-bearing securities, issued by a company, which are listed on a recognised stock exchange. The roster of recognised stock exchanges includes some with fewer administrative burdens (such as the Channel Islands Securities Exchange) and it is only necessary for the debt to be listed (and so subject to an appropriate level of regulatory supervision), even if it is not expected to be actively traded.

In its Spring Budget 2017, the UK Government announced plans to introduce an exemption from withholding tax for interest on debts traded on MTFs. These are known as alternative trading systems in the United States. MTFs are generally used by wholesale debt markets which look to raise funding from institutional investors.

The Government consultation paper, released on March 20, 2017, notes that very little UK debt is traded on MTFs in contrast to the practice in other jurisdictions. MTFs in jurisdictions such as Luxembourg and Ireland meet the local listing conditions of exchanges that are on HMRC's roster of recognised stock exchanges, and so debts listed on those exchanges would qualify for the 'quoted Eurobond' exemption. UK MTFs do not meet the admission and disclosure requirements of the UK's listing rules, and so debt traded on UK MTFs would not qualify for the 'quoted Eurobond' exemption.

The proposed new exemption for debts traded on MTFs is aimed at making UK MTFs more competitive internationally.

Conclusion

The changes to the DTTP Scheme and proposed new exemption in respect of MTFs are further steps in the UK Government's bid to make lending into the UK more attractive. It follows the exemption that came into force on January 1, 2016 for Qualifying Private Placements, which applies to certain loans from unconnected lenders resident in treaty jurisdictions. The consultation on the exemption for securities traded on MTFs will close in June 2017 and new rules are expected to apply from 2018.

If you have any questions regarding this memorandum, please contact Judith Harger in London (+44 20 3580 4705, jharger@willkie.com) or the Willkie attorney with whom you regularly work.

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