HM Revenue
& Customs

Deduction of income tax from payments of yearly interest: private placements

Technical Note
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Introduction

The Government announced on 3 December 2014 that it will introduce legislation to amend the rules on deduction of income tax at source from yearly interest, where the interest is paid on ‘qualifying private placements’

This Technical Note sets out proposed draft legislation to provide such an exemption.

How to comment

Comments on this Technical Note should be sent to tony.sadler@hmrc.gsi.gov.uk or mark.lafone@hmrc.gsi.gov.uk by 27 February 2015.

Alternatively HM Treasury and HMRC will be willing to meet interested parties directly to discuss points raised in this Technical Note. Please contact adam.terry@hmtreasury.gsi.gov.uk or tony.sadler@hmrc.gsi.gov.uk if you wish to do so.

Chapter 1: overview

1.1 Private placements are a form of unlisted debt instrument. The *Breedon Report* of March 2012 recommended increasing the number of UK-based private placement investors through an industry initiative led by the Association of Corporate Treasurers (ACT), in order to unlock a new source of financing for mid-sized borrowers. The ACT subsequently recommended introducing a new exemption for private placements from the requirement to deduct income tax at source from interest.

1.2 Where a UK company pays interest on borrowings, tax rules require the company to deduct income tax from the payment. Where the recipient is liable to UK income tax, this mechanism provides administrative convenience for both the payer and HMRC. However, not all recipients are liable to UK income tax, for example if they are resident outside the UK. Consequently, there are a number of exemptions from this requirement, and where the borrowing is from a non-UK lender, double taxation treaties commonly allow interest to be paid gross or at a reduced rate of withholding.

1.3 In order to prevent the rules on deduction of income tax from inhibiting development of the UK private placement market the Government proposes to provide a specific exemption for private placements that meet certain qualifying conditions.

1.4 The Government will introduce primary legislation to set out certain gateway conditions for the application of the exemption. The primary legislation will also allow regulations to be made to set out more detailed conditions to be met for private placements to qualify for the exemption.

1.5 This Technical Note describes the primary legislation proposed for inclusion in Finance Bill 2015, and outlines the regulations that would subsequently be made under the primary legislation. The power to make the regulations will come into force on the date of Royal Assent to the Finance Bill in which it is enacted.

Chapter 2: primary legislation

2.1 A new section 888A of the Income Tax Act 2007 (ITA) will provide that the duty to deduct a sum representing income tax under section 874 ITA does not apply to a payment of yearly interest on a ‘qualifying private placement’. The draft legislation for inclusion in Finance Bill 2015 is set out in Chapter 4 of this Technical Note.

2.2 A qualifying private placement will mean a security which meets certain key conditions, and which also meets other conditions specified in regulations.

2.3 The three key conditions will be as follows:

- The security is a loan relationship of the company. That is, the interest paid on the instrument falls to be deducted under the corporation tax rules that apply to debt issued by a company.
- The security will be issued for a minimum period of three years. Interest paid on short term debt instruments will not be eligible for the exemption.
- The security must not be listed on a recognised stock exchange. Instruments that are listed on a recognised stock exchange already qualify for an exemption under section 882 ITA.

2.4 In addition to setting out these key conditions, the primary legislation allows for further conditions to be specified in regulations, in order for a security to qualify as a qualifying private placement. These further conditions will relate to the security itself and the terms and conditions of its issuance, and to the issuer and holder of the security.

2.5 The ability to deal with such issues in regulations will permit the conditions to be appropriately targeted and to contain safeguards to ensure the exemption is not abused. It will also enable them to be adapted as necessary in light of the development of the UK private placement market. The regulations envisaged for such qualifying private placements are set out in Chapter 3 of this Technical Note.

Chapter 3: secondary legislation

3.1 The detail of regulations to be made under the primary legislation will be developed in consultation with stakeholders. The regulations will have effect in relation to securities issued on or after a date specified in a Treasury Order.

3.2 The broad policy aim behind the regulations is to target the exemption from the duty to deduct income tax at source on interest paid on a qualifying private placement at midsize companies and infrastructure projects, which it is envisaged will be the typical borrowers under this form of debt instrument. The regulations will also contain safeguards to ensure that withholding obligations that otherwise apply to interest paid by companies remain generally applicable. It is, therefore, proposed that regulations would cover the following areas:

- Conditions that apply to the issuer of the security
- Conditions that apply to the holder of the security
- Conditions that apply to the security itself.
- An anti-avoidance provision.
- Other conditions.

3.3 The paragraphs below describe in outline the regulations that would relate to each of these areas.

Conditions applying to the issuer of the security

3.4 Qualifying conditions relating to the issuer would include the primary requirement that the issuer must be a trading company. The exemption is not intended to be available for issuer companies whose business consists primarily of making or holding investments. It is proposed that the definition of 'trading company' for the purposes of the regulations would follow that in Part 3 of Schedule 7AC to the Taxation of Chargeable Gains Act 1992.

3.5 The regulations would contain further conditions that would limit the availability of the exemption. While it is not considered appropriate to restrict, within the regulations, the type or size of company that may be an issuer, regulations would set a minimum and a maximum issuance size by an individual company. Consistent with the experience of other private placement markets, it is proposed that the minimum issuance of a qualifying private placement by an individual company would be £10 million, and the maximum issuance by an individual company would be £300 million.

Conditions applying to the holder of the security

3.6 Qualifying conditions relating to the holder (or investor) would include the primary requirement that the holder of the security must not be connected with the issuer. For the purposes of the regulations it is proposed that the definition of 'connection' would follow that in section 993 of the Income Tax Act 2007.

3.7 Consistent with the policy objective that the emerging private placement market should provide a wider range of non-bank finance options for businesses, it is proposed that a qualifying investor for the purposes of the exemption should be a UK- regulated financial institution, or an equivalent entity authorised outside the UK carrying on substantially similar business.

3.8 A qualifying investor would be required to be resident in a 'qualifying territory'. This term would take its meaning from section 173 of the Taxation (International and Other Provisions) Act 2010 (TIOPA), and refers to a territory with which the UK has a double taxation treaty which includes an appropriate non-discrimination article. The HMRC International Manual has a list of such 'qualifying territories' at INTM412090. 'Resident' for these purposes is defined in section 167(5) of TIOPA, and means liable to tax there by reason of domicile, residence or place of management.

3.9 A qualifying investor would be treated as a holder of a security if it stands indirectly in that position by reference to a series of loans. The legislation would thus look to the person who holds the instrument for their own benefit and not as intermediary for some other person.

3.10 A qualifying investor would be required to certify on acquisition, and at specified intervals thereafter, that it meets the investor conditions.

Conditions applying to the security

3.11 The regulations would include certain qualifying conditions relating to the security itself, intended to ensure that the exemption is targeted at market-standard, plain vanilla forms of debt, and to minimise the risk of structured avoidance arrangements. It is envisaged that these would include the requirements that the instrument must:

- Be unsubordinated to any existing unsecured debt of the issuer.
- Have a maturity of between three and thirty years.
- Pay interest at a normal commercial rate.
- Be issued in a minimum denomination of £100,000.
- Have no right to conversion into shares of the issuing company.

Securities held for an unallowable purpose

3.12 The regulations would contain an anti-avoidance provision that the security must be issued and held for genuine commercial reasons, and not as part of a tax advantage scheme.

3.13 ‘Scheme’ here would take the normal definition used in anti-avoidance rules of ‘any scheme, arrangements or understanding of any kind whatever, whether or not legally enforceable, involving a single transaction or two or more transactions’.

3.14 ‘Tax advantage scheme’ would mean a scheme the main purpose, or one of the main purposes, of which is to obtain a tax advantage (other than a negligible tax advantage), and ‘tax advantage’ would have the meaning given by section 1139 of CTA 2010.

Other conditions

3.15 The regulations would provide for the consequences of a qualifying private placement terminating within a specified period. In such cases, the rules on deduction of income tax from yearly interest in Part 15 of the Income Tax Act 2007 would have effect in relation to any payment of interest on the qualifying private placement as if the exemption from the duty to deduct income tax had never been applied.

Comments

3.16 HMRC invites comments on the proposed regulations outlined in this Chapter.

Chapter 4: Draft legislation for Finance Act 2015

Finance Act 2015: new section 888A Income Tax Act 2007: exemption from duty to deduct income tax from qualifying private placements

(1) In Chapter 3 of Part 15 of ITA 2007 (deduction of tax from certain payments of yearly interest), after section 888 insert -

‘888A Qualifying private placements

(1) The duty to deduct a sum representing income tax under section 874 does not apply to a payment of interest on a qualifying private placement.

(2) Qualifying private placement means a security -

(a) which meets Conditions A, B and C, and
(b) in relation to which such other conditions as the Treasury may specify by regulations are met.

(3) Condition A is that the security -
(a) is issued by a company, and
(b) represents a loan relationship to which the company is a party as debtor.

(4) Condition B is that the terms of the loan relationship represented by the security do not provide for the loan relationship to terminate within 3 years of its coming into force.

(5) Condition C is that the security is not listed on a recognised stock exchange.

(6) The conditions which may be specified in regulations include conditions relating to-
(a) the security itself,
(b) the loan relationship represented by the security,
(c) the terms or circumstances of the issue of the security,
(d) the issuer of the security, or
(e) the holder of the security.

(7) Regulations under this section may make provision about the consequences of failing to make a deduction under section 874, in respect of a payment of interest on a security, in cases where -
(a) the person required to make the deduction had a reasonable, but mistaken, belief that the security was a qualifying private placement, or
(b) the loan relationship represented by the security terminates within 3 years of the loan relationship coming into force.

(8) Regulations under this section may -
(a) make different provision for different cases;

(b) contain incidental, supplemental, consequential and transitional provision and savings.

(9) In this section loan relationship has the same meaning as in Part 5 of CTA 2009.'

(2) Any power conferred on the Treasury by virtue of subsection (1) to make regulations comes into force on the day on which this Act is passed.

(3) So far as not already brought into force by subsection (2), the amendment made by this section comes into force on such day as the Treasury may by regulations appoint.

(4) Section 1014(4) of ITA 2007 (regulations etc subject to annulment) does not apply to regulations under subsection (3).

Chapter 5: Explanatory Note

EXCEPTION FROM DUTY TO DEDUCT TAX: QUALIFYING PRIVATE PLACEMENTS

SUMMARY

1. Clause [X} amends the rules on the deduction of income tax from payments of yearly interest. It provides for an exception from the duty to deduct income tax for interest paid on qualifying private placements.

DETAILS OF THE CLAUSE

2. Subsection (1) of the clause inserts a new section 888A into Chapter 3 of Part 15 of the Income Tax Act 2007 (ITA).

3. Subsection (1) of new section 888A provides that the duty to deduct income tax from yearly interest does not apply to a 'qualifying private placement'. This is defined in subsection (2) as a security which meets Conditions A to C, and such other conditions as are set in regulations. Conditions A to C are set out in subsections (3) to (5).

4. Condition A is that the security must be issued by a company and represent a debtor loan relationship of the company. Subsection (9) provides that 'loan relationship' takes its meaning from Part 5 of the Corporation Tax Act 2009.

5. Condition B is that the security must have a minimum term of three years.

6. Condition C is that the security is not listed on a recognised stock exchange.

7. Subsections (6) to (8) of new section 888A set out the provisions that apply to regulations made under this section. They provide, among other matters, that the regulations may set out conditions relating to the security itself, the issuer and the holder of the security, the consequences where a security ceases to be a qualifying private placement, and to transitional and similar cases.

8. Subsection (2) to (4) of the clause set out the commencement provisions. The power to make regulations under the new section 888A comes into force on the date of Royal Assent of the Finance Act. The exemption from the duty to deduct income tax will apply from a date to be set in regulations.

BACKGROUND NOTE

9. Private placements are a form of unlisted debt instrument. The *Breedon Report* of March 2012 recommended increasing the number of UK-based private placements investors in order to unlock a new source of financing for mid-sized borrowers.

10. Where a UK company pays yearly interest on borrowings, tax rules require the company to deduct income tax from the payment. However, there are a number of exemptions from this requirement, and where the borrowing is from a non-UK lender, double taxation treaties commonly allow interest to be paid gross or at a reduced rate of withholding. This measure aims to remove an obstacle to the development of the UK private placement market by providing a specific exemption for private placements that meet certain qualifying conditions.

11. The power to make regulations provided in this measure allows detailed conditions to be set out in relation to private placements that qualify for the exemption from the duty to deduct income tax from interest payments. These regulations may allow the exemption to be targeted at particular types of company, and may contain safeguards to ensure the exemption is not abused.

If you have any questions about this change, or comments on the legislation, please contact Tony Sadler on 03000 585479 (email: tony.sadler@hmrc.gsi.gov.uk).