HM Revenue & Customs

Double Taxation Treaty Passport scheme review

Consultation Response

20 March 2017

Contents

1. Introduction

On 26 May 2016 HMRC published a consultation document "Double Taxation Treaty Passport scheme review". This can be found at:

> https://www.gov.uk/government/consultations/double-taxation-treaty-passport-scheme-review

The purpose of the consultation was to explore whether HMRC should renew and extend the administrative simplifications of the existing Double Taxation Treaty Passport (DTTP) scheme. The closing date for responses was 12 August 2016.

HMRC received 17 written responses and met with a small number of respondents. HMRC is very grateful to all the respondents which included accountancy firms, lawyers, tax advisers, sovereign wealth funds (SWF) and representative bodies. A list is included at Annex A.

Responses were sought to ten questions under the following headings:

- Renewing the scheme;
- Treaty Passport renewal process;
- Sanctions for misuse;
- Extending the scheme;
- UK partnerships as borrowers;
- Overseas partnerships as lenders; and
- Sovereign investors and pension funds.

The following questions were asked:

> Question 1: Is the current DTTP scheme meeting its objective of providing an administrative simplification for corporate-to-corporate lending and should it be continued? The alternative would be to return to the "certified claim" approach for each loan.
>
> Question 2: Do the current DTTP arrangements create any barriers to the making of debt-based investments in the UK?
>
> Question 3: Is the passport renewal process operating appropriately? If not, how should it work?
>
> Question 4: Do the sanctions for misuse of the scheme need to be changed and/or strengthened?
>
> Question 5: Is the current scope of the scheme, which mainly covers corporate-to-corporate lending, adequate? If expansion is advantageous, what entities should and should not be admitted to the scheme and why?
>
> Question 6: What potential benefits and/or difficulties may arise from admitting UK partnerships to the DTTP scheme as borrowers?
>
> Question 7: What potential benefits and/or difficulties may arise from issuing passports to partners in overseas partnerships if they are admitted to the DTTP scheme as lenders?

Question 8: If overseas partnerships were admitted to the DTTP scheme as lenders, how would HMRC police this and receive sufficient information on the parties involved to prevent abuse, whilst keeping the compliance burden low on both sides? For example, should partners' passports have a shorter duration of one or two years and be contingent on all of the partners being either companies or individuals resident in the same jurisdiction?

Question 9: Are there any obstacles to prevent sovereign investors and overseas pension funds being admitted to the DTTP scheme, such as issues of liability to tax and entity characterisation? Admittance to the DTTP scheme would also require publication of their names in the public register of passported lenders.

Question 10: Other than those detailed above, what investment structures are typically used by sovereign investors and pension funds, and are these suited to the mechanics of the DTTP scheme?

Key elements of the Government's response are:

- The scheme will be made available to all UK borrowers that have an obligation to deduct withholding tax, including UK partnerships, individuals and charities.

- Transparent entities (including partnerships) will be admitted to the scheme as lenders where all of the constituent beneficial owners of the income are entitled to the same treaty benefits under the same treaty.

- Sovereign wealth funds and pension funds who are utilising withholding tax treaty rates will be admitted into the scheme as lenders.

- DTTP scheme's Terms and Conditions and guidance will be updated and published on 6 April 2017.

This document summarises the responses received and the Government's response as appropriate.

2. Responses

2.1 Renewing the DTTP scheme

Question 1

Is the current DTTP scheme meeting its objective of providing an administrative simplification for corporate-to-corporate lending and should it be continued? The alternative would be to return to the "certified claim" approach for each loan.

Responses and comments received (17 responses):

- The DTTP scheme is meeting its objective of providing an administrative simplification for corporate-to-corporate lending and should be continued.
- None of the respondents supported a return to the certified claim approach.

Question 2

Do the current DTTP arrangements create any barriers to the making of debt-based investments in the UK?

Responses and comments received (15 responses):

- The DTTP scheme encourages foreign based investments into the UK.
- It was noted that the publicly available list of passported entities may be a disincentive for some entities to use the scheme due to concerns around publishing commercially sensitive information. So, where possible, some lenders would prefer to rely on the Qualifying Private Placement ("private placement") exemption.
- While the DTTP scheme does not raise any barriers per se, the fact that it is not available to non-corporate borrowers or lenders creates barriers for those entities by exclusion.
- Some of the practicalities of the scheme's operation also cause issues for certain areas of the debt market such as: securitisations, the secondary loan market, syndicated loan arrangements and collateralised loan obligations - where it was felt the DTTP scheme should take a more "pragmatic" approach.
- There were some areas of perceived ambiguity in the current guidance around the DTTP scheme: particular examples involved the eligibility of non-UK borrowers with UK source income seeking to use the scheme, and whether the scheme can be used by lenders whose claim for treaty relief from withholding tax (WHT) relies on an article other than the Interest article in the relevant tax treaty.
- Condition 1 of the DTTP scheme Terms and Conditions should be amended from the present position of stating that passporting applies to UK corporate borrowers, to stating that non-UK companies and UK permanent establishments of non-UK companies can also be included.

- The delay of up to 30 days for a borrower to receive the Direction following submission of the DTTP2 form can cause practical difficulties. Suggestions to improve this included:

    - Allowing the borrower to pay the treaty rate immediately following submission (as the DTTP scheme has already "pre-cleared" the lender, subject to HMRC having power to issue a notice that a treaty exemption does not apply and tax is to be withheld).
    - An electronic submission of form DTTP2 with HMRC providing an automatic response.
    - HMRC issuing Directions by email.
    - Eliminating the need for the borrower to submit form DTTP2 altogether and moving towards a fully self-certified regime (similar to that contained in the private placement legislation).
    - Amending the requirement that a borrower submit form DTTP2 each time a loan is issued from the same lender, to only one submission of form DTTP2 being required in respect of a single lender.
    - All borrowers should be allowed to use form DTTP2A to speed up the application process.

Government response

- The DTTP scheme will be renewed and expanded from 6 April 2017. The guidance and Terms and Conditions will be amended and made available through the gov.uk website.
- Digital changes are being considered and HMRC has noted the suggestions. However, it is anticipated that any changes made through digitisation will be on a later timeline.
- The current scheme's technical questions and answers (available on the internet) contain guidance on syndicated loans, and this will continue to apply to the new scheme.
- HMRC will still require the submission of form DTTP2 for all loans wishing to make use of the DTTP scheme. This is to allow HMRC to ensure the integrity of the scheme and to fulfil its obligations to our treaty partners.
- Form DTTP2A is specifically designed to facilitate the operation of syndicated loans within the DTTP scheme. It would not be appropriate to extend its use further.

2.2 Treaty Passport renewal process

Question 3

Is the passport renewal process operating appropriately? If not, how should it work?

Responses and comments received (9 responses):

- The renewals process is working effectively but, as the DTTP scheme itself was only introduced in September 2010, a significant proportion of passported lenders have yet to undertake the renewal process.
- Extend the maximum duration of a passport from five years. Potentially allow a maximum passport duration of ten years or introduce 'perpetual' passports.

- Investment funds with specified lifespans should be able to be awarded a passport for the whole life of the fund if all other conditions for granting are met.
- It was noted that the current guidelines state that passports will be renewed for five years if there are no material changes - but the current conditions of the DTTP scheme require HMRC to be notified in any case if there are material changes to form or circumstances. This suggested that the renewal process was effectively automatic as things stand, and that perpetual passports combined with an enhanced obligation for lenders to notify HMRC of a change of status would reduce the administrative burden on both parties.
- It is not the passport itself which confers gross or treaty rate payment rights, but rather the Direction. The borrower, as things stand, must provide individual loan details to HMRC via form DTTP2 to obtain that Direction and HMRC thus would retain the discretion to deny treaty benefits regardless of the length of the passport.

Respondents to this question also made several suggestions for improvements to the operation of the renewal process. These included:

- Introduction of an online renewal service, including acceptance of scanned copy documents instead of originals.
- Having the DTTP scheme operate on a calendar year basis, i.e. passport is effective for five years following the year the application is submitted and approved.
- Form DTTP1 should ask the applicant to provide details of a principal contact at the lender. In some cases renewal correspondence was being sent to the company's registered address, where in fact it was a central tax team or third party who was responsible for administering the scheme for the company.
- Allowing a DTTP2 to be filed for any loans advanced by a lender whilst they are waiting on their application for a passport to be determined. It was highlighted that this would be particularly useful for new lenders whose lending activities start within a very short period after their establishment, particularly those lending through special purpose vehicles.
- A link to the DTTP scheme Terms and Conditions to be included on the Treaty Passport website.
- Reminders to renew a lender's passport should be issued six months before the passport expires.
- The published register of passport holders should include a 'Valid To' date, which would easily allow lenders to check when their passport is nearing expiry, as well as allowing borrowers to ensure that the passport is not likely to expire before the DTTP2 form is submitted and a Direction issued.
- To clarify an apparent inconsistency between the DTTP scheme's Terms and Conditions and the latest guidance. The former suggests that lenders should apply for renewal not less than four months before expiry, whereas the latter advises HMRC will write to all existing passport holders three months before the passport is due to expire to request a renewal application.
- Should HMRC decide to issue longer-term passports in particular circumstances, then the DTTP guidance should be updated to clearly set out the factors that would be taken into account in reaching such a decision.

Government response

- Due to the age of the scheme, there have been relatively few renewals which provides little scope to review the process.

- There are no plans to increase the duration of the passports beyond 5 years, or to introduce perpetual passports, as in doing so there is a risk that HMRC's assessing powers would be compromised.
- There are no plans to move to a calendar year basis as this would cause undue administrative pressures on HMRC.
- Digital changes are being considered and HMRC has noted the suggestions. However, it is anticipated that any changes made through digitisation (including amendments to existing forms) will be on a later timeline.
- HMRC will continue to monitor the renewals process and any changes will be incorporated in the DTTP scheme's Terms and Conditions and associated guidance which will be available on the gov.uk website.
- HMRC will consider what (if any) additional information can be included on the passport register while maintaining taxpayer and commercial confidentiality.
- Lenders will take full responsibility for ensuring that renewal applications are made timeously.
- There are no plans to change the conditions that have to be met before a DTTP2 can be filed.

2.3 Sanctions for misuse

Question 4

Do the sanctions for misuse of the DTTP scheme need to be changed and/or strengthened?

Responses and comments received (3 responses):

- The present range of sanctions for misuse of the DTTP scheme are appropriate.
- Clearer guidance should be issued, including some examples of when HMRC would look to use the more serious sanctions: such as suspension or removal of status.

Government response

- There are no plans to introduce additional sanctions for the newly extended scheme.
- As the DTTP scheme will remain a non-legislative administrative simplification HMRC will reserve broad discretionary powers over who has access to it. Entities refused access to the scheme will still have access to treaty benefits through the standard certified claim method.

2.4 Extending the DTTP scheme

Question 5

Is the current scope of the DTTP scheme, which mainly covers corporate-to-corporate lending, adequate? If expansion is advantageous, what entities should and should not be admitted to the scheme and why?

Responses and comments received (20 responses):

- Strong support for extending the DTTP scheme beyond corporate-to-corporate lending, to reduce the administrative burdens on both overseas lenders and HMRC as well as lowering the cost of introducing finance into the UK.
- It was noted, in respect of the obligation of lenders under the scheme, that possessing full corporate personality is not a necessary condition for responsibility or accountability of action, and that the starting point for eligibility should be whether the lender would be entitled to use the certified claim procedure, with a list of exclusions. Arguably the only exclusion should be individuals, or partnerships whose membership included individuals.
- The DTTP scheme should cover all treaty compliant lending situations not covered by the private placement or quoted Eurobonds provisions.
- An expanded scheme should place a clear onus on the lender to comply with the requirements, supported by clear parameters in the Terms and Conditions.
- Virtually all respondents identified that partnerships (and related entities such as LLPs and Scottish Limited Partnerships) should be admitted to the DTTP scheme as lenders. The General Partner should be able to provide the necessary certification of eligibility to HMRC, much as they currently self-certify under the private placement legislation.
- A majority of respondents were in favour of admitting other transparent vehicles such as Unit Trusts and Contractual Funds, while all respondents who expressed an opinion on sovereign wealth funds and Pensions Funds suggested they should also be admitted to the DTTP scheme as lenders.
- Widening the scope of the DTTP scheme to transparent lenders such as partnerships and trusts would be of considerable benefit in the Corporate Real Estate sector, where such lending structures are particularly common and who at present may be dis-incentivised to invest in the UK market due to administrative and financial costs as a result of being unable to access the DTTP scheme.
- There may be operational and compliance issues arising from widening the scope of the DTTP scheme, particularly in respect of overseas partnerships, but in general the benefits to HMRC in dealing more simply with this range of loans would outweigh the risk.
- Clarification on a couple of points of guidance was requested:

    - Firstly, what can constitute a ‘loan’ for the purposes of the DTTP scheme? Is it restricted to a loan relationship as defined by section 302 Corporation Tax Act 2009, or can it be expanded to include any arrangements giving rise to payments that are capable of constituting ‘yearly interest’.
    - Secondly, some guidance was requested on whether corporate-to-corporate lending in a commercial mortgage backed securitisation scheme can make use of the DTTP scheme.

Government response

- The scheme will be renewed and extended.
- The scheme will be available to all UK borrowers that have an obligation to deduct withholding tax, including UK partnerships, individuals and charities.
- The scheme will also extend to include more lenders, although it will not be possible to extend the scheme as widely to lenders as borrowers. The basic, overriding principle is that transparent entities should be admitted to the scheme as lenders where all of the constituent ultimate beneficial owners of the income are entitled to the same treaty benefits under the same treaty.
- This will closely resemble the principle that any entity who is currently entitled to make use of the certified claim procedure on its own account will be able to apply for a passport under the DTTP scheme.
- This will, for instance, include overseas partnerships, but only where all partners are resident in the same jurisdiction and entitled to the same treaty benefits. Consideration has been given to allowing mixed-jurisdiction memberships, but the organisational and compliance constraints are considered to outweigh the benefits of allowing additional lenders access to the scheme.

2.5 UK partnerships as borrowers

Question 6

What potential benefits and/or difficulties may arise from admitting UK partnerships to the DTTP scheme as borrowers?

Responses and comments received (8 responses):

- Strong support for UK partnerships to be admitted to the DTTP scheme as borrowers as this would provide administrative relief and a reduction in their compliance burden - as well as providing HMRC administrative relief. Examples given of specific types of partnership who would benefit included non-UK entities lending cross-border and within a multi-national group.
- There should be no difficulties with admitting partnerships, as the nature and status of members of a partnership has no bearing on the obligation to withhold tax on interest payments due to a lender, or the entitlement of a lender to rely on a double taxation treaty. Therefore concerns over changes in membership of a partnership, or requirements to notify over any such changes, should not arise. Where the partnership itself is a UK permanent establishment of its (non-UK resident) partners, or where the partnership's partners are UK residents, then there should be no barrier to admitting such partnerships. Also, where all partners are entitled to identical treaty rates, there should be no difficulty in allowing their partnership to obtain a passport, which ought to be issued to the partnership rather than the partners as individuals.
- There is a strong case for partnership borrowers to be included in the scope of the DTTP scheme despite being outside the scope of the Quoted Eurobond and private placement exemptions from WHT, as it is commercially more common for partnerships to be borrowing rather than lending.
- Presently a UK partnership fund vehicle with a one-year-plus bridge loan from a foreign passported bank is unable to access the DTTP scheme, which ought not to be the case.

Government response

- As noted above, UK partnerships will be admitted to the scheme as borrowers.

2.6 Overseas Partnerships as lenders

Question 7

What potential benefits and / or difficulties may arise from issuing passports to partners in overseas partnerships if they are admitted to the DTTP scheme as lenders?

Responses and comments received (12 responses):

- Strong support for admitting overseas partnerships to the DTTP scheme as lenders.
- The reduction in administrative burden and associated costs that overseas partnerships would expect to benefit from if eligible for passports is likely to encourage overseas partnerships to invest in the UK, to the benefit of the UK economy.
- Partnerships who have a limited number of borrowers or whose membership remains largely constant are likely to be most attracted by this proposed change.
- Private equity or real estate funds who lend to UK companies are likely to find the inclusion of overseas partnerships as being favourable, as these funds will normally make a number of investments.
- In the context of overseas debt funds being constituted as partnerships, a further benefit arises by simplifying the treaty process for both HMRC and the debt fund as, once eligibility has been established, there would be a single point of contact for treaty applications (the fund itself, rather than a series of treaty applications from different investors).
- Difficulties may arise in recording and monitoring the identities of partners in overseas partnerships, and determining their eligibility for relief as exemptions under a tax treaty will ordinarily be dependent on partner identity and eligibility. There may also be difficulties linked to having partnerships whose memberships change during the life of the passport.
- Partnerships with more fluid membership may essentially be prevented from taking part in the DTTP scheme due to the extra administrative burden that their compliance and notification obligations would bring.
- The present Terms and Conditions of the DTTP scheme state that lenders are under a duty only to use their passport in circumstances where the conditions for the treaty relief to which the passport relates are met, and to notify HMRC of material changes. Similar concerns as those which have previously excluded partnerships (i.e. the desire to have participating entities who are wholly responsible and accountable for their actions) are present where overseas partnerships are permitted to make 'certified claims' on behalf of their partners, so these concerns should not operate to exclude partnerships from the operation of the DTTP scheme.
- A ‘General’ Partner - who is responsible for the administration and management of their partnership and who has the power to bind the partnership - was suggested to have the requisite responsibility and accountability required for operation within the DTTP scheme.
- Failure to include partnerships in the DTTP scheme incentivises them to lend through corporate subsidiaries that qualify for treaty relief and can obtain passports, which is

contrary to general global trends such as the concepts put forward by the OECD BEPS (Base Erosion and Profit Shifting) project. Including partnerships in the DTTP scheme could counter this.

- A loan which is made from a partnership, which has regard for the tax status of each of the separate partners, is more likely to be taking into account, in the first instance, those who are the ultimate recipients of the UK source interest income. Having the DTTP mechanism already capable of dealing with this situation will give the DTTP scheme the level of flexibility required to deal with any changes to the application of double tax treaties that may result from BEPS.
- Further complications may arise when deciding on any applicable restrictions to allowing overseas partnerships into the DTTP scheme. Examples given were:

    - Whether all partners should be "passport eligible" bodies or whether a small percentage (e.g. 20%) could be "non-passport eligible" bodies.
    - Whether all partners have to be resident in the same treaty country or in a treaty country that gives the same tax rate, although it would be useful if passports could be issued where partners were resident in different jurisdictions.
    - Mapping the "creditor certificate" mechanics from the private placement legislation over to the DTTP.
    - Whether the duration of the passport should be shorter than the standard five years.
    - Whether the Directions themselves could be issued in respect of a shorter period.
    - What happens where income (especially interest) allocations between partners is variable or where one of the partners is not entitled to any of the interest.

Question 8

If overseas partnerships were admitted to the DTTP scheme as lenders, how would HMRC police this and receive sufficient information on the parties involved to prevent abuse, whilst keeping the compliance burden low on both sides? For example, should partners' passports have a shorter duration of one or two years and be contingent on all of the partners being either companies or individuals resident in the same jurisdiction?

Responses and comments received (16 responses):

- Responses to this question varied widely. Some suggested a short passport should be issued initially to the partnerships. Others emphasised this would create unnecessary restrictions and a five year passport in line with the corporate-to-corporate arrangements should be issued. However, in spite of what was said in answer to Question 7 about it being useful if passports could be issued to partners resident in different jurisdictions, all respondents to this question agreed that restricting the DTTP scheme to partnerships with members only from same jurisdiction is unnecessary, and would exclude most partnerships from accessing the scheme.
- Some suggested the DTTP scheme should be available only to partnerships in which all members are entitled to same rate of relief. Others noted this would impose unnecessary restrictions on such partnerships' ability to admit new partners with different rates of relief and suggested the scheme should extend to all partnerships even if members are entitled to different rates of relief including some entitled to no relief.

- However it was noted that making the DTTP scheme available to a partnership where members are entitled to different rate of relief could potentially introduce significant complexity.
- Some suggested HMRC should direct the borrower to withhold tax at a blended WHT rate calculated using the information from the initial application, along with directing the partnership to allocate interest to its members according to their entitlement.
- Others suggested that a portion of the payments should be made under the certified claim route.
- The majority felt a 'nominated partner' or 'designated partner' should monitor and notify HMRC of any changes in partnership membership, which would affect the WHT rate.
- Passport holders should provide borrowers and/or HMRC with periodic statements confirming there have been no membership changes.
- To minimise any potential abuse of the DTTP scheme a suggestion was also made to restrict the scheme to partnerships with up to 20 members.

Government response

- Overseas partnerships will be admitted to the scheme as lenders, but only where all partners are resident in the same jurisdiction and entitled to the same treaty benefits. This restriction is needed to ensure that the newly extended scheme meets its objective of providing administrative simplifications which, as some respondents have noted, would not be available if the scheme was extended to all overseas partnerships.
- Each partnership lender will appoint a "designated" or "nominated" partner, who will be responsible for making the initial application, corresponding with HMRC and notifying any relevant changes.

2.7 Sovereign investors and pension funds

Question 9

Are there any obstacles to prevent sovereign investors and overseas pension funds being admitted to the DTTP scheme, such as issues of liability to tax and entity characterisation? Admittance to the DTTP scheme would also require publication of their names in the public register of passported lenders.

Responses and comments received (13 responses):

- The DTTP scheme should be available to overseas sovereign investors, provided that they otherwise qualify for treaty benefits.
- Respondents suggested that sovereign entities should be able to make use of an expanded DTTP scheme outside the treaty context. This would allow eligible sovereign investors to obtain relief at source rather than reclaim a refund of WHT which the current system requires. This would reduce the administrative burden of claims on both sides.
- Where an entity is entitled to sovereign immunity and is a partner or investor in a transparent entity that is itself a qualifying lender in an expanded DTTP scheme, it was suggested that the sovereign entity be treated in the same manner as investors entitled to zero percent rates of WHT under their relevant treaty.

- The requirement for sovereign investors to have their names published on a register might cause some concern. However as these investors could still use the certified claim method this was not viewed as a significant issue.
- Overseas pension funds should be eligible for the DTTP scheme if they are otherwise eligible to claim treaty benefits currently, though it was noted that HMRC would need to publish very clear rules on which types of pension funds could qualify - possibly by providing a list of relevant entities per country as an annex to the revised guidance.
- For both sovereign investors and overseas pension funds the question as to whether they should qualify for a revised DTTP scheme ultimately depends on the facts of how they are constituted and the terms of the relevant treaty.

Question 10

Other than those detailed above, what investment structures are typically used by sovereign investors and pension funds, and are these suited to the mechanics of the DTTP scheme?

Responses and comments received (10 responses):

- Certain SWFs reported that their investments are not made directly, but rather through an Investment Management structure (such as a Unit Trust) or through an interposed entity structure involving an entity with corporate character such as a Limited Liability Partnership (LLP) or a Scottish Limited Partnership (LP). Some SWFs also choose to incorporate a special purpose vehicle (SPV) in a relevant treaty jurisdiction to make loans into the UK. The purpose of doing this was to ring fence any potential liabilities.
- It is common for corporate SPVs to be set up to take advantage of the DTTP scheme. If the DTTP scheme were to be expanded to include a broader range of entities as qualifying entities these SPVs may not be needed - potentially reducing the cost of lending to the UK.
- There was a request for detailed and unambiguous guidance on how the scheme will interact with BEPS AP6.

Government Response

- Sovereign investors and pension funds who are utilising treaty WHT rates will be admitted into the scheme on the same grounds as other lenders, i.e. where the beneficial owners are entitled to the same treaty benefits under the same treaty.
- The DTTP scheme will not be extended at this time to those investors who benefit from Sovereign Immunity as it would not provide the administrative simplification that the wider scheme provides

3. Next Steps

The DTTP scheme's Terms and Conditions and guidance will be updated and published on 6 April 2017. All subsequent changes to the scheme's operation (for example, digitisation) will be announced and incorporated within further updates to the Terms and Conditions.

Any queries about the contents of this document should be addressed to:

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Annex A

List of Respondents

- Queensland Investment Corporation
- New Zealand Superannuation Fund
- AIMA
- M&G Investments
- CIOT
- Slaughter & May
- Simmons & Simmons
- Weil, Gotshal & Manges
- Canadian Pension Plan Investment Board
- Ashurst
- BlackRock
- Burges Salmon
- CBI
- CREFC-Europe and BPF
- Eversheds
- KPMG Australia
- KPMG
- PwC
- Sidley Austin LLP
- Loan Market Association