HM Revenue
& Customs

Withholding Tax Exemption for Debt Traded on a Multilateral Trading Facility

Summary of Responses
13 September 2017

Contents

1. Introduction

1.1 At the March 2017 Budget, the government announced its intention to introduce, following consultation, an exemption from withholding tax for interest on debt traded on certain trading platforms known as Multilateral Trading Facilities (MTF) in order to make UK wholesale debt markets (that is, those focused on institutional investors) more internationally competitive.

1.2 Accordingly, on 20 March HMRC published a consultation document “Withholding Tax Exemption for Debt Traded on a Multilateral Trading Facility”. This can be found at:

> https://www.gov.uk/government/consultations/withholding-tax-exemption-for-debt-traded-on-a-multilateral-trading-facility

1.3 The consultation put forward, and invited comment on, a proposed legislative approach to the change. This document summarises the responses to the consultation and sets out the government’s intentions in the light of them.

Background

1.4 There has been a decline in the use of the UK as a location for trading corporate debt since 2009. Against that background, the UK Debt Market Forum, set up by the Financial Conduct Authority in 2015, identified a need to improve the competitiveness of UK MTFs as alternatives to traditional debt markets.

1.5 It has become clear that current requirements to withhold tax on interest are a barrier to the establishment of MTFs in the UK. This is because debt traded on a UK MTF would not benefit from an existing exemption from withholding requirements - the Quoted Eurobond Exception (QEE) - while similar debt traded on some overseas MTFs would. This means that UK MTFs suffer a competitive disadvantage, making them commercially unattractive.

1.6 The government recognises that there are market operators in the UK which are keen to establish wholesale debt MTFs and that often UK companies would prefer to issue debt by way of a UK venue if it were commercially competitive to do so. Indeed, following the Budget announcement, the London Stock Exchange announced the launch of a new debt MTF in the UK - the International Securities Market.

1.7 The government is therefore seeking to ensure that UK debt markets can compete internationally on an equal footing by ending the anomaly which leads UK companies to issue debt on overseas venues in order to benefit from an existing UK exemption from withholding of tax on interest.

1.8 In pursuit of this objective the consultation set out the following policy considerations:

- enhancement of the competitiveness of UK wholesale primary debt markets;
- revenue neutrality for the Exchequer
- maintenance of the link between regulatory requirements and the Quoted Eurobond Exemption (QEE).

1.9 The consultation invited comments on a proposal to introduce legislation to provide that section 874 of the Income Tax Act 2007, which would otherwise require tax to be withheld, should not apply to a payment of interest where:

- the interest arises on a security issued by a company
- the interest-bearing security is admitted to trading on a multilateral trading facility
- that facility is operated by a recognised stock exchange regulated in an EEA territory.

1.10 The closing date for responses was 12 June 2017.

2. Responses

2.1 HMRC received 16 written responses and met with a small number of respondents. Respondents included law firms, market operators and representative bodies - a full list is at Annex A. Some of the responses were in considerable detail, and all were helpful.

2.2 Although the summary which follows necessarily omits much of the detail in individual responses, all contributions have been fully considered. The government wishes to thank those who responded to the consultation document.

2.3 All respondents welcomed the government's announcement and agreed with the government's assessment that the proposed change would remove a critical barrier to the development of MTFs in the UK.

> *"The proposal is totally consistent with HMG's overall mission to achieve a more global Britain. Listing bonds and being a centre for global capital raising represents an important signal of Britain being open for business with a global outlook…"*

2.4 As well as inviting general comment on the proposal, the consultation posed a number of specific questions, and responses to these are summarised below.

Question 1. Comments are invited on the impact and effectiveness of all aspects of the proposal and the extent to which it will achieve the policy objectives described in Chapter 3. If you consider there is any reason why it would not, please explain why not. We welcome suggestions as to how the proposal might better match the policy objectives

2.5 There were 13 responses to this question.

2.6 The proposal was welcomed by all commentators and there was general agreement that the policy objectives set out in the consultation and at paragraph 1.8 above would be met.

> *"[We] consider the proposal will be effective to achieve the policy objective of enabling issuers to compete on an equal footing with overseas MTF listings."*

> *"We agree with HMRC's assessment that the proposal is revenue neutral and would maintain appropriate regulatory standards (i.e. as the proposal is a tax simplification not a tax relief and because MTFs in the EEA are regulated under MiFID.)"*

2.7 Three respondents were concerned to ensure that the proposed change would continue to operate for UK MTFs with the UK no longer part of the EEA. The government confirms that this is its intention.

Question 2. Do you agree that exemption from withholding tax is a key element in encouraging the development of MTFs in the UK? To what extent are there other factors which would continue to impede it?

2.8 There were 12 responses to this question.

2.9 All agreed that the proposed exemption would remove a key barrier to the development of UK debt MTFs.

> *"Achieving an equivalent exemption from withholding tax is a critical precondition to the success of a new wholesale debt MTF in the UK. Another important factor...will be its ability to maintain rigorous disclosure standards...while allowing for a degree of flexibility appropriate to a wholesale market which will only be used by sophisticated professional investors."*

2.10 A minority of respondents made broader recommendations including changes to Stamp Duty Reserve Tax, grouping and distributions rules, and a general overhaul of the UK tax regime for yearly interest. The government notes these suggestions but considers that they are not critical to achieve the aim of the proposal under consultation. The issues raised do not amount to serious impediments to the development of UK MTFs.

2.11 Two respondents suggested that the QEE be extended to cover debt issued by local authorities as well as by companies. Currently local authorities seeking to raise debt finance in the market are unable to access the QEE directly, but may do so indirectly, for instance by issuing the debt through a special purpose company. This was seen as an unnecessary complication. The government has carefully considered the point, but does not consider that there is a compelling case to make this change. It relates to the general scope of the QEE rather than to the purpose of this consultation, which is about the competitiveness of UK MTFs specifically.

Alternative finance

2.12 It was pointed out that there are specific provisions in the UK tax framework to clarify the tax treatment of 'alternative finance investment bonds' (AFIB) - these are Shari'a-compliant financial instruments also known as 'sukuk'. Under these rules, such issues are treated as debt, and the return on them as interest. In order to qualify as an AFIB, the arrangements must be a "listed security on a registered stock exchange" as defined in UK tax legislation.

2.13 Instruments traded on a UK MTF would not meet the requirement of the UK's listing rules so cannot be treated as "listed" under the legislation. This "listing" requirement varies according to local regulatory arrangements in the territory in which a trading venue is regulated. This means that in some territories, such as Luxembourg and Ireland, local listing requirements are met. Instruments traded on MTFs in such territories would therefore be able to qualify for AFIB status. Instruments that are traded only on a UK MTF would not, giving rise to a further competitive disadvantage for the UK.

2.14 The government recognises that AFIB status is important because it provides a straightforward and certain treatment, avoiding the need for market participants to undertake complex legal and tax analysis. This would be likely to lead issuers to prefer an overseas MTF, offering simplicity and certainty, over an equivalent UK venue.

2.15 The government therefore intends to widen the tax definition of AFIBs to include securities admitted to trading on an MTF regulated in the EEA. This change will apply from 1 April 2018 for income tax and corporation tax purposes. It is in line with the government's aim of facilitating internationally competitive MTFs in the UK and broadening the circumstances in which there is equivalence between the tax treatment of AFIBs and conventional debt.

Question 3. Comments are invited on anticipated behavioural effects of the proposed change on the issuance of debt. In particular, to what extent would you expect issuances and trading to take place on any new UK MTFs which would otherwise have taken place on overseas venues in order to access the QEE?

2.16 There were 9 responses to this question.

2.17 The majority of respondents believe that UK companies would often prefer to issue debt on a UK trading venue if it were commercially competitive to do so and that the proposal would therefore lead to an increase in the use of UK MTFs by UK and overseas debt issuers.

2.18 One respondent was concerned that the measure would be limited to third party debt, although this was not proposed in the current consultation.

> *"Most importantly, we agree with HMRC analysis that suggests an increase in debt issuance from UK companies using UK venues since they would no longer, under the proposed changes, be at a competitive disadvantage for doing so."*

Question 4. The proposal could be achieved by widening the existing QEE or by providing a stand-alone exemption. Is there any commercial reason to prefer either of these over the other?

2.19 There were 12 responses to this question.

2.20 This question was included to ensure that the government's intention is realised in a way which best accommodates the practicalities of the market. A significant majority of respondents preferred widening the existing QEE over a stand-alone exemption. This was seen as a simpler solution that would be more easily understood by market participants.

> *"...market participants have [said] that for maximum positive impact on supporting issuer, advisor and investor interest in any new UK debt MTF it would be ideal to be able to promote the market as allowing access to exactly the same fiscal framework as overseas competitor stock exchanges."*

Question 5. Do you have any comments on the assessment of equality and other impacts in the summary of impacts on page 10?

2.21 There were 7 responses to this question.

2.22 Most respondents agreed that the proposal would be revenue neutral to the Exchequer. The other respondents believed that there would be a positive economic impact in the longer term as the proposal would lead to an increase in business and financial activity. No respondents believed there would be a negative impact on the Exchequer.

2.23 No comments were made on other impacts.

3. Conclusions and next steps

3.1 The government has carefully noted the responses received, and intends to proceed with the proposal set out in the consultation document, and on the proposed timescale, so that the changes will have effect from 1 April 2018.

3.2 The change will be made by extension of the QEE rather than by way of a new stand-alone exemption from the requirements of section 874 of the Income Tax Act 2007.

3.3 In addition changes will be made to extend the definition of AFIB arrangements to include securities admitted to trading on an MTF regulated in the EEA, as discussed in paragraphs 2.12 to 2.15.

3.4 The government will publish draft legislation for comment for inclusion in the Winter Finance Bill.

Annexe A: List of stakeholders consulted

Association of British Insurers

Association for Financial Markets in Europe

Ashurst LLP

British Bankers' Association

British Chambers of Commerce

Confederation of British Industry

Corporation of London

Herbert Smith Freehills LLP

The Investment Association

International Capital Market Association

London Stock Exchange Group

NEX Group plc

Primary Markets Group, London Stock Exchange

Quoted Companies Alliance

TheCityUK

White & Case LLP