HM Revenue & Customs

# Withholding Tax Exemption for Debt Traded on a Multilateral Trading Facility

**Consultation document**

Publication date: 20 March 2017

Closing date for comments: 12 June 2017

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| **Subject of this consultation:** | This consultation is about exempting payments of interest on debt traded on a Multilateral Trading Facility (MTF) from withholding tax. |
| **Scope of this consultation:** | At the spring 2017 Budget, the government announced its intention to introduce a new exemption from withholding tax for interest on debt traded on a MTF. This consultation invites comment on a proposal for implementing this intention. |
| **Who should read this:** | Operators or potential operators of MTFs; operators of other venues on which debt instruments are traded; issuers and holders of debt instruments and their advisers. |
| **Duration:** | The consultation starts on 20 March 2017 and ends on 12 June 2017. |
| **Lead official:** | Mark Lafone - HM Revenue and Customs (HMRC). |
| **How to respond or enquire about this consultation:** | By email to: mark.lafone@hmrc.gsi.gov.uk or by post to:<br><br>Mark Lafone<br>HM Revenue & Customs<br>Room 3C/06<br>100 Parliament Street<br>London<br>SW1A 2BQ |
| **Additional ways to be involved:** | HMRC and HM Treasury officials will welcome bilateral meetings with interested parties where they will add materially to written submissions. |
| **After the consultation:** | A summary of responses will be published later this year. Legislation is expected to be included in Finance Bill 2017-18 with effect from April 2018. |
| **Getting to this stage:** | It has become clear that current requirements to withhold tax on interest are a barrier to the establishment of debt MTFs in the UK. The government is keen to remove this barrier, enabling UK MTFs to compete on an equal footing with MTFs established overseas. |
| **Previous engagement:** | Some preliminary discussions have been held with interested parties, including the Financial Conduct Authority, and representations have been received from parties wishing to establish MTFs in the UK and from investors. |

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# 1. Introduction

1.1 At Budget in March 2017, the government announced its intention to introduce an exemption from withholding tax on interest for debt traded on Multilateral Trading Facilities (MTF), in order to make UK wholesale debt markets (that is, those focused on institutional investors) more competitive. The government also announced a consultation on the detailed implementation of the change.

1.2 This consultation sets out an outline proposal, and we are now seeking views from interested parties, including exchanges, potential debt issuers and investors, and their arrangers and advisors, to ensure the design of this exemption is as effective as possible and without unintended effects.

## Why is the government making this change?

1.3 There has been a decline in the use of the UK as a trading venue for corporate debt since 2009. Moreover, almost all of the debt listed in the UK is on regulated markets, as opposed to other platforms such as MTFs, in contrast to practices in other jurisdictions. For example, 28% of debt securities in Ireland and Luxembourg are now listed on MTFs[1], while less than 1% of UK issuances are on an MTF.

1.4 In November 2015 the Financial Conduct Authority (FCA) set up the UK Debt Market Forum. This brought together a range of experts to develop a package of practical measures which could improve the effectiveness of the UK's primary debt markets, without compromising the high regulatory standards for which the UK is known.

1.5 The Forum focused on wholesale debt capital raisings, which make up one of the largest single financial asset classes globally; the world's largest companies and agencies undertake the majority of their capital funding with institutional investors in this way.

1.6 The Forum's report in April 2016 ('*Practical measures to improve the effectiveness of UK primary listed debt markets*[2]'), identified the need to address the competitiveness of UK "exchange-regulated" markets, or MTFs, as alternatives to traditional debt markets. Subsequently, the FCA explored this issue further in its February 2017 discussion paper *'Review of the Effectiveness of Primary Markets: The UK Primary Markets Landscape'*[3].

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[1] Source: Financial Conduct Authority, 'Review of the Effectiveness of Primary Markets: The UK Primary Markets Landscape' (February 2017)

[2] Available at: https://www.fca.org.uk/publication/newsletters/practical-measures-improve-effectiveness-uk-primary-listed-debt-markets.pdf

[3] Available at: https://www.fca.org.uk/publication/discussion/dp17-02.pdf

1.7 The FCA's work with the debt market indicated that some market participants would value the development of new wholesale UK MTFs, focused on institutional investors, as this would enhance the country's reputation as a competitive jurisdiction in which to issue and trade debt. It would also deepen UK financial markets' liquidity pool by increasing the number of investors, in turn helping domestic companies to access debt capital via a UK venue; and it would benefit the UK financial services industry as a whole.

1.8 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.

# 2. MTFs and the Quoted Eurobond Exemption

## What is a multilateral trading facility?

2.1 Over the past decade the use of specialist MTFs focused on wholesale bonds has been a significant development in European debt capital markets. MTFs provide debt issuers with alternative venues for raising debt finance, other than traditional regulated markets.

2.2 The MTF concept was established by the EU's Markets in Financial Instruments Directive (MiFID). MiFID distinguishes and defines two kinds of multilateral trading venue, namely 'regulated markets' and 'multilateral trading facilities'. A third type of venue will be introduced in the form of 'organised trading facilities' from 2018 when MiFID II applies. The rules for admission to, and operation of, these different types of venue differ, but within the EU, all are subject to regulation under the MiFID framework.

2.3 An MTF is defined by MiFID as:

> *a multilateral system, operated by an investment firm or a market operator, and which brings together multiple third-party buying and selling interests in financial instruments - in the system and in accordance with non-discretionary rules - in a way that results in a contract in accordance of the provisions of Title II.*[4]

## The Quoted Eurobond Exemption

2.4 Companies (and some other entities) that pay interest with a UK source have a prima facie obligation to withhold a sum representing income tax and to pay it to HMRC[5]. The rate of withholding follows the basic rate of income tax, currently 20 per cent.

2.5 This withholding tax may be reduced or eliminated where the interest is payable to a recipient in another territory which has a tax treaty with the UK. But even where a tax treaty does apply, investors must comply with various administrative requirements to ensure the interest can be paid without deduction or to reclaim deducted tax.

2.6 In addition to bilateral tax treaties the UK has a number of domestic exemptions from withholding tax on interest. One of these domestic exemptions is the Quoted Eurobond Exemption (QEE)[6].

2.7 The QEE removes the requirement to withhold tax on payments of interest arising in the UK made by a company on debt which is 'listed' on a 'recognised stock exchange'

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[4] Directive 2004/39EC/EU of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments at article 4 (15).

[5] See section 874 Income Tax Act 2007.

[6] See section 882 Income Tax Act 2007

(a list of UK and international exchanges approved by HMRC[7]). Availability of the QEE therefore depends on the debt in question being subject to an appropriate level of regulatory supervision.

2.8 The QEE plays a valuable role in making it easier and cheaper for UK companies to access international capital markets. In most cases the recipient of the interest would be entitled to repayment of the tax deducted, or to be paid gross, under a double taxation treaty, reflecting the fact that the recipient will instead be liable for tax on that payment in their own country of residence. Applying withholding would be an unnecessary administrative burden for the borrower, the lender and for HMRC.

## Issue to be addressed

2.9 Under existing legislation interest on debt traded on wholesale UK MTFs is not covered by the QEE. This is because such securities, unlike those traded on a regulated market, do not meet the admission and disclosure requirements of the UK's listing rules so they would not be 'listed'.

2.10 However, the listing requirement of the QEE applies by reference to local regulatory arrangements in the territory in which a trading venue is regulated. Because these arrangements differ from territory to territory, in some cases local listing requirements are met and the QEE is available. This means that debt traded on MTFs in Luxembourg or Ireland, for instance, does attract the exemption, whereas the same securities traded on a wholesale UK MTF would not. UK MTFs therefore suffer a significant commercial competitive disadvantage in attracting business.

[7] Section 1005 Income Tax Act 2007 defines 'recognised stock exchanges'.

# 3. Policy Objectives

3.1 The government is 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 a UK exemption.

3.2 In pursuit of this objective the government will have regard to the following policy considerations:

- competitiveness of UK wholesale primary debt markets;
- revenue neutrality; and
- maintenance of the link between regulatory requirements and the QEE.

## Competitiveness of UK wholesale primary debt markets

3.3 The government believes that extending the QEE to cover debt traded on wholesale UK MTFs would be well received by business, and that without an exemption it would be very difficult for such a market to compete, given the current offerings available in overseas jurisdictions. It is anticipated that this change will be critical in stimulating the establishment of new debt MTFs in the UK.

## Revenue neutrality

3.4 This measure should have negligible Exchequer impact. Our expectation is that it will mean an increase in debt issued on MTFs in the UK which will now benefit from the exemption. However, we anticipate the vast majority, if not all, of this new issuance in the UK will be of debt which would otherwise have been introduced on foreign exchanges which already benefit from the QEE. The government wants to test this understanding in consultation, and invites comment on anticipated behavioural effects of the change on the issuance of debt.

## Maintenance of the link between regulatory standards and the QEE

3.5 The government wishes to maintain the existing principle of linking availability of the QEE with appropriate regulatory requirements for the debt in question. Within the EEA, MTFs are subject to the requirements of MiFID, whether regulation is imposed directly by the regulatory authority of the territory concerned or by market operators under the supervision of the regulatory authority. In the case of debt MTFs, the government is satisfied that these markets would be appropriately regulated for the QEE to apply.

# 4. Proposal

## Proposal

4.1 The legislative changes required to apply the QEE to debt traded on wholesale UK MTFs need not be extensive. We are therefore not providing draft legislation as part of this consultation. However, we envisage that legislation will provide that the duty to deduct a sum representing income tax under section 874 does not apply to a payment of interest:

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

4.2 The first of these bullets mirrors defining characteristics of a quoted Eurobond as set out in section 987(a) and (c) Income Tax Act 2007. The requirement for 'admission to trading' on an MTF differs from the QEE requirement for listing, but we believe will ensure that the security in question will be subject to regulation under the MiFID framework. Limiting the change to the EEA ensures that MiFID regulation will apply to all venues affected by this change, and ensures a level playing field across the EEA. As with all aspects of tax policy, we will keep these conditions under review.

4.3 We expect this legislation will be included in Finance Bill 2017-18 and would take effect from April 2018.

# 5. Questions

Q1. 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.

Q2. 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?

Q3. As noted in paragraph 3.4, 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?

Q4. The proposal could be achieved by widening the existing the QEE or by providing a stand-alone exemption. Is there any commercial reason to prefer either of these over the other?

Q5 .Do you have any comments on the assessment of equality and other impacts in the summary of impacts on page 10?

# 6. Summary of Impacts

**Summary of Impacts**

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| **Exchequer impact** | The Exchequer impact will depend on the final detailed policy design, which will be informed by this consultation. However, the overall impact is expected to be small.<br><br>The final costing will be subject to scrutiny by the Office for Budget Responsibility, and will be set out at a future fiscal event |
| **Economic impact** | The measure is expected to remove a barrier to the development of UK debt markets. |
| **Impact on individuals, households and families** | The proposed changes will apply only to companies. The measure will have no impact on individuals, or on family formation, stability or breakdown. |
| **Equalities impacts** | This measure applies only to companies and it is not anticipated that it will impact on any group with protected characteristics. |
| **Impact on businesses and Civil Society Organisations** | This measure will facilitate the development of UK debt markets. Whilst there may be some initial familiarisation costs for those wishing to benefit from the exemption, it will not impose any new ongoing administrative burdens on business. |
| **Impact on HMRC or other public sector delivery organisations** | It is not anticipated that implementing this change will incur any additional costs for HM Revenue & Customs (HMRC). |
| **Other impacts** | Other impacts have been considered and none have been identified. |

# 7. The Consultation Process

This consultation is being conducted in line with the Tax Consultation Framework. There are 5 stages to tax policy development:

Stage 1 Setting out objectives and identifying options.

Stage 2 Determining the best option and developing a framework for implementation including detailed policy design.

Stage 3 Drafting legislation to effect the proposed change.

Stage 4 Implementing and monitoring the change.

Stage 5 Reviewing and evaluating the change.

This consultation is taking place during stage 2 of the process. The purpose of the consultation is to seek views on the detailed policy design and a framework for implementation of a specific proposal.

## How to respond

Responses should be sent by 12 June 2017, by e-mail to mark.lafone@hmrc.gsi.gov.uk or by post to:

Mark Lafone
HM Revenue & Customs
Room 3C/06
100 Parliament Street
London
SW1A 2BQ

Telephone enquiries 03000 585613 (from a text phone prefix this number with 18001)

**Please <u>do not send consultation responses to the Consultation Coordinator.</u>**

Paper copies of this document or copies in Welsh and alternative formats (large print, audio and Braille) may be obtained free of charge from the above address. This document can also be accessed from HMRC's GOV.UK pages. All responses will be acknowledged, but it will not be possible to give substantive replies to individual representations.

When responding please say if you are a business, individual or representative body. In the case of representative bodies please provide information on the number and nature of people you represent.

## Confidentiality

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentially can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Revenue and Customs (HMRC).

HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

## Consultation Principles

This consultation is being run in accordance with the Government's Consultation Principles.

The Consultation Principles are available on the Cabinet Office website: http://www.cabinetoffice.gov.uk/resource-library/consultation-principles-guidance

If you have any comments or complaints about the consultation process please contact:

John Pay, Consultation Coordinator, Budget Team, HM Revenue & Customs, 100 Parliament Street, London, SW1A 2BQ.

Email: hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk

**Please do not send responses to the consultation to this address.**

# Annex A: Relevant Current Legislation

## Deduction of tax

A.1 The statutory provisions on the duty to deduct a sum representing income tax from various types of payments, including interest are set out in Part 15 of the Income Tax Act 2007 ('ITA')

A.2 Section 874 ITA applies to 'yearly interest' paid by a company, a local authority, a partnership of which a company is a member, and by a person to another person whose usual place of abode is outside the UK. There are a number of important exceptions from the requirement to deduct tax under section 874. These are in sections 875 to 888, and include, at section 882, payments of interest on quoted Eurobonds.

A.3 Quoted Eurobonds are defined for the purposes of the rules on deduction of tax at section 987 ITA as interest bearing securities, issued by a company and listed on a recognised stock exchange.

## Recognised stock exchange

A.4 Recognised stock exchanges are defined in section 1005 Income Tax Act 2007.

## MTF

A.5 An MTF is defined in Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments.