HM Revenue & Customs

HM Treasury

Reform of Taxation of Securitisation Companies

Summary of Responses

30 November 2021

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1. Introduction

Securitisations: commercial background

1.1. Securitisations are an important part of the UK's capital markets and an important source of finance for UK businesses.

1.2. Securitisation is a widely used method of raising debt finance on the capital markets through the issue of asset-backed securities. It can also aid capital, liquidity and risk management. In typical securitisations, income-producing assets (for example loans) are used as collateral backing for the issue of securities by a bankruptcy-remote special purpose vehicle (the note-issuing SPV). As part of the process the assets are usually transferred directly or indirectly by the originator of the assets to the note-issuing SPV, which uses the proceeds of the issue of securities to purchase the assets.

1.3. The note-issuing SPV typically acts as a conduit through which income flows from the securitised assets are channelled to the investor in the form of interest. It will normally only retain a small cash profit over the life of the transaction.

Securitisations: special corporation tax rules

1.4. The government acknowledges the important role securitisations play in funding, and in capital, liquidity and risk management. Recognising the limited role of the note-issuing SPV, the government's corporation tax policy is that tax is only paid on the cash profit, provided certain conditions are met (these are set out further below).

1.5. Before 1 January 2005 accounting profits would largely reflect the cash profit, and corporation tax would therefore be chargeable on that profit under usual principles. Changes in the application of accounting standards from 1 January 2005 led to increased volatility in the accounting profits of note-issuing SPVs. As a result, the statutory accounts no longer formed a suitable basis for calculating the note-issuing SPV's corporation tax liability. Special corporation tax rules were therefore introduced in order to enable the securitisation market to continue to function effectively.

1.6. An 'interim regime' for securitisations was introduced from 1 January 2005. The Taxation of Securitisation Companies Regulations (SI 2006/3296, the 'Regulations') were then introduced in 2006, and brought the 'permanent regime' into effect from 1 January 2007. The Regulations apply to companies involved in the securitisation of financial assets, as defined in Regulation 9A, which meet legislative tests to be a 'securitisation company'. These tests include that they have provision for a 'retained profit', i.e., an amount required to be retained as profits.

1.7. If a company is a securitisation company, and meets certain further conditions, the consequence is that it will be taxed on, and only on, its 'retained profit' for corporation tax purposes.

1.8. The key type of securitisation company is the SPV which issues the securities, the 'note-issuing company', as defined in Regulation 5. The company must be party as a debtor to a 'capital market investment' in respect of which securities are issued and which is part of a 'capital market arrangement' (Regulation 5(2)), and three further conditions must be met:

I. the securities representing the capital market investments must be issued wholly or mainly (which is interpreted by HMRC as more than 50%) to independent persons (Regulation 5(3))
II. the total value of the capital market investments made per capital market arrangement, and therefore of notes issued representing those capital investments, must be at least £10m – the 'note issuance threshold' (Regulation 5(4))
III. the company's only business, apart from being a debtor to a capital market arrangement and from any incidental activities, must be acquiring, holding or managing financial assets forming the whole or part of the security for the capital market arrangement (or equivalent rules in relation to guarantor arrangements) (Regulation 5(5)).

Stamp Duty, Stamp Duty Reserve Tax (SDRT) and Insurance-Linked Securities ('ILS')

1.9. Stamp Duty is a charge on (paper) instruments that transfer the beneficial interest in stock or marketable securities. SDRT is charged on agreements to transfer uncertificated (paperless) shares and other chargeable securities. Both Stamp Duty and SDRT are normally charged at 0.5% of the consideration (payment) received. A higher 1.5% Stamp Duty or SDRT rate can apply in certain circumstances where securities are transferred into an overseas clearance service or depositary receipt system. SDRT is not payable where either a document has been stamped for Stamp Duty purposes or is exempt from Stamp Duty.

1.10. Loan capital is money which a company raises from borrowing rather than the issue of shares (equity). The transfer of loan capital is generally exempt from Stamp Duty (and therefore SDRT) under the loan capital exemption at section 79 of Finance Act 1986. There are exceptions to this for loan capital which is in some way equity-related, for example by carrying a return linked to the profits of a business (section 79(6)(b) of Finance Act 1986) or which carries a right to an excessive rate of return or repayment (section 79(6)(a)). There are specific savings from the exceptions to the exemption, for example for certain limited recourse securities which are capital market investments issued as part of capital market arrangements (section 79(7B)).

1.11. ILS arrangements are an alternative form of risk mitigation for insurance and reinsurance companies, which offer a means of transferring insurance risk to capital market investors, and are an established part of the global reinsurance and risk mitigation markets. An ILS arrangement will typically involve an insurer or reinsurer transferring specific risks to an insurance special purpose vehicle (ISPV). The ISPV will then issue notes to investors to raise sufficient capital to cover the transferred insurance risk. An ISPV which meets the conditions specified in The Risk Transformation (Tax) Regulations (SI 2017/1271) is known as a 'qualifying transformer vehicle'.

Consultation

1.12. A consultation entitled 'Reform of Taxation of Securitisation Companies' was published on 23 March 2021, for response by 3 June 2021.

1.13. The consultation aimed to understand whether it would be beneficial to make changes to clarify and/ or reform aspects of the Regulations, and aspects of the Stamp Duty loan capital exemption as it applies to securitisations and to ILS. This was to ensure that the UK's tax code keeps pace with the evolving nature of the capital markets, and contributes to maintaining the UK's position as a leading financial services centre.

1.14. Specifically the consultation considered the following areas:

I. circumstances where an originator acquires more than 50% of the securities from the note-issuing company, possibly on a short-term basis ('retained securitisations')
II. what types of assets can be securitised
III. the operation of the note issuance threshold for the note-issuing company
IV. the application of the exemption from Stamp Duty (and therefore SDRT) for loan capital to securitisation arrangements, and to ILS arrangements.

1.15. Fifteen written responses to the consultation were received. Six of these were from representative bodies or charities, in some cases jointly; nine were from firms of advisers. No responses were received from individuals.

1.16. A virtual meeting was held with an industry consultative group previously established by HMT and HMRC, the Securitisation Industry Working Group ('SIWG'), comprising a range of advisory firms who act for securitisation industry participants. Further calls and/or virtual meetings were also held with participants who were acting on behalf of, or who were members of, the SIWG and organisations which had provided written responses. The government is grateful for all the input received, both by way of the initial written responses, and in calls, virtual meetings and correspondence.

1.17. In addition to addressing the questions raised directly in the consultation, some respondents offered input on questions of scope of the securitisation regime. These, and the government's response, are covered in the response to Question 4.

1.18. In responses to the consultation and in ongoing engagement with industry, it has been suggested that it would be beneficial to address the complexity of the current VAT rules, and the extent to which irrecoverable VAT creates a cost, in the securitisation context. The government has noted these comments.

2. Responses

Question 1: What are respondents' views on the commercial importance of retained securitisations, the drivers for such securitisations, and the impact of being able to carry out such securitisations in the UK on the competitiveness of the UK as a financial services centre?

2.1 There was very strong support for the view that retained securitisations are an important component of the commercial securitisation market.

2.2 Respondents identified a number of drivers for such securitisations. Some respondents explicitly confirmed the drivers given as examples in Section 2.2 of the consultation: to hold securities temporarily until market conditions allowed transfer to investors in the market, and to create collateral eligible for the Bank of England term funding scheme. Many respondents pointed to a wider range of drivers. For instance, respondents pointed to the use of retained securitisations to create securities which can be used as collateral eligible for central bank liquidity schemes generally, or in secured funding, or in other internal or external exposures; or to create securities which can be a source of contingent liquidity.

2.3 Being able to carry out retained securitisations in the UK with certainty that they are within the Regulations was confirmed as important to the competitiveness of the UK as a financial services centre.

2.4 The government's view is that the responses to Question 1 strongly support the case for change in this area, further details of which are given below.

Question 2: What changes by way of clarifying and/or reforming the Regulations in relation to retained securitisations would be helpful, and what form should they take? What would be the benefits and any potential difficulties of making any such changes?

2.5 Most respondents put forward possible approaches for change to legislation, some offering a number of alternatives.

2.6 Many suggested applying a different test of what constituted an independent person, by altering the test of connection, so that the application of Regulation 5(3) fits better with current commercial practice. This might take the form of making amendments to specific areas of potential uncertainty, or making more general changes to the test of connection.

2.7 Some suggested removing Regulation 5(3) altogether.

2.8 One suggestion was permitting more than 50% of notes to be issued to persons who were not independent, but only in defined circumstances reflecting typical commercial retained securitisations, or only where more general tests of commerciality, for instance by reference to motive, were met. Another suggestion was that rules could expressly provide that the test should be applied only in respect of the ultimate recipient of the notes in certain situations.

2.9 Some suggested putting explicitly in legislation HMRC's existing views in relation to Regulation 5(3), as already expressed in guidance and in separate formal engagement with industry.

2.10 Some respondents made suggestions for non-legislative change, proposing that at a minimum it would be helpful to expand HMRC guidance, in particular to include the content of the separate formal engagement with industry.

2.11 In putting forward these options respondents generally identified the benefits as being greater certainty and/or greater flexibility to permit commercially driven retained securitisations, and the difficulties, for the narrower options, as being that areas of uncertainty or inflexibility would remain.

2.12 Of the various options put forward, the government's view is that two options (repeal of the Regulation 5(3) test, or changes to the definition of independence) would give the greatest level of certainty and flexibility to cover commercially driven retained securitisations.

2.13 Looking at these two options in more detail, the government recognises that repeal would maximise certainty and flexibility, and would remove any concern that the test is a barrier which discourages location of securitisations in the UK. The government further recognises that repeal would open up the regime to a significantly wider range of types of investor. However, the government's view is that there continues to be value in having a test designed to ensure the involvement of participants with some degree of independence from the note-issuing company. The question of whether the regime should be available to a significantly wider range of types of investors will be considered separately (see Question 4, below).

2.14 The government proposes instead to pursue the second option and introduce legislation to alter the test of independence. Under the revised test, independence will be tested by reference to control of an entity's affairs through the holding of shares, possession of voting rights, or powers given by articles of association. This test will be simpler and easier to apply. It is intended, in particular, to have the effect that an originator is generally treated as independent from the SPV in commercially driven retained securitisations. The government recognises that the revised test will generally be easier to meet than the existing test, but considers that other safeguards within the regime provide sufficient protection against use of the Regulations for unintended purposes.

Question 3: Should the scope of assets which can be securitised within the Regulations be expanded beyond financial assets as defined in Regulation 9A? What would be the benefits and potential difficulties for the UK in doing so?

2.15 Most respondents supported an extension in the scope of assets which can be securitised. Where benefits were expressly identified, these were greater flexibility and/or certainty. No significant potential difficulties were identified: the few respondents who commented on difficulties did so in terms of the need to limit the scope of extensions appropriately, which they felt could be achieved.

2.16 The government's response is set out below in the response to Question 4.

Question 4: If the scope of assets were expanded, what assets should be included, and should that only be under specified circumstances? For instance, should shares be included but only as part of restructuring/bailout of an existing securitisation?

2.17 Most respondents favoured an extension to permit the longer-term holding of shares (or options or warrants over shares) obtained as part of a restructuring or bailout of an existing securitisation, or otherwise in the enforcement of security in relation to securitised assets.

2.18 Some favoured an extension to permit such assets to be transferred into securitisation arrangements at the start, provided they were appropriately linked to core financial assets being transferred in, for instance by requiring that the "dominant purpose" of the securitisation should be to hold financial assets.

2.19 Some respondents asked for specific extensions, for instance in relation to finance leases.

2.20 A few respondents favoured significant extensions in scope, for instance one respondent referred to the securitisation tax regime in Ireland, stating that this permits a substantially wider range of assets.

2.21 Many respondents saw the question as overlapping with other scope questions in relation to the regime: in particular, the scope of activities permitted within Regulation 5(5), and the extent to which the regime permits access to certain sectors and types of investors.

2.22 Some respondents suggested that the ability to hold shares, options and warrants, whether from the start if linked to the core financial assets, or as a result of subsequent restructuring or bailout or enforcement, might be appropriately dealt with through the application of the incidental activities test. Several requested clarification on what fell within the scope of permitted activities, whether as incidental or otherwise, for instance in relation to the transfer in of security rights, the level of activity permissible in relation to distressed assets, and the extent to which any disposal of assets could take place. Several respondents asked for clarification of, or change to, the extent to which the regime enables access to certain sectors and types of investor, for instance platform lenders and credit funds.

2.23 Some respondents suggested that where proposed changes were not substantive, clarification by guidance could be possible instead of legislative change.

2.24 Representations that it would be useful to review and clarify the activities permitted, and to consider the extent to which the regime enables access to certain sectors and types of investor, have also been made to HMRC by industry in ongoing engagement.

2.25 The government notes that the case for change on some of these points will be affected by the separate new regime for qualifying asset-holding companies (the 'QAHC regime') which is being introduced in Finance Bill 2021-22.

2.26 In the light of the responses to this question, and of the other input officials have received, the government has decided that before making any decisions on legislative or other change in this area, officials should further consult informally on the activities test as a whole (types of asset and permitted activities), and on whether the regime is available to the appropriate range of sectors and types of investor, including reflecting on how the Regulations fit with the QAHC regime. This further engagement may lead to a second formal consultation focused on these points.

2.27 As set out in Section 3.6 of the consultation, the government has been separately exploring the implications of holding land in securitisation arrangements. While this was outside the scope of this consultation, some respondents also commented briefly on it. In summary, there has been interest, although quite limited, in developing possibilities for holding land in securitisation arrangements, perhaps restricted to non-UK land, or perhaps using a modified regime. The government notes the risks of eroding the UK tax base by extending the regime in its current form to UK land.

2.28 The government will continue to explore this area informally, in parallel with the wider further informal consultation on extending the scope of securitisations within the regime set out above.

Question 5: If the scope of assets were expanded, what would be the implications for interaction with other parts of the UK tax code? What consequential changes, if any, would be appropriate?

2.29 Respondents did not generally consider this in any detail, beyond noting that the implications and any consequential changes would need to be addressed but would depend on the particular option pursued.

2.30 The government proposes to explore this further in the informal consultation set out above.

Question 6: Should the threshold limit per capital market arrangement be changed and if so, to what sum and why? Should the threshold be subject to any other amendment: for instance, should it be possible to take into account an issue made earlier in an accounting period in assessing whether the threshold is met for a second issue later in the period? If so, how and why?

2.31 Several respondents stated they had not seen a need for change to the threshold limit or to the operation of the threshold.

2.32 Other respondents suggested the threshold limit per capital market arrangement should be reduced. Several simply requested that it be lowered, several raised the possibility of removing the threshold test altogether, and several suggested specific figures, or ranges. There was strong support for lowering the threshold to £5 million from the charity and social impact organisations sector.

2.33 The suggestions were made on the basis that the current level of threshold unduly restricts access to the regime: some respondents identified, in particular, access by charities and social impact organisations, and access by other sectors, such as small and medium-sized enterprises ('SMEs') and the specialist non-bank businesses which lend to them.

2.34 In terms of the operation of the threshold, a number of changes were suggested. Several supported the option of taking into account an issue which met the threshold under one capital market arrangement in determining whether the threshold was met for subsequent issues under a different capital market arrangement or arrangements. Others suggested that the threshold test should be applied not at the initial issue but for aggregate issues under the capital market arrangement within, say, the same accounting period. A further possibility raised was that the threshold test could be applied to the aggregate value of issues under all capital market arrangements within an accounting period or within a defined period, say a rolling twelve – month period.

2.35 Again, the suggestions were made on the basis that the current test unduly restricts access to the regime.

2.36 In terms of the level of the threshold, the government's view is that having a threshold at an appropriate level balances access to the regime against risks that taxpayers may inadvertently fall within it (see Question 7 for further discussion of this). Further, a lower threshold might encourage the use of relatively complex arrangements to raise comparatively small amounts of finance, giving rise to an increased risk of non-compliance with significant regulatory as well as tax requirements.

2.37 The government considers that the threshold should be lowered to £5 million on the basis that this represents an appropriate balance in relation to these factors.

2.38 In terms of the operation of the threshold, any benefits of additional flexibility from the various proposed changes should be balanced against the extra complexity which would be introduced. Given the proposed lowering of the threshold to £5 million, the government's view is that any such benefits do not justify the increased complexity.

Question 7: If any such changes are proposed, what would be the best way of minimising the risk that arrangements are inadvertently caught by the amended rules?

2.39 Some respondents commented that the current regime did not result in a material risk that arrangements are inadvertently caught.

2.40 Most respondents did not comment on whether making the changes resulted in a material risk, but simply suggested that, to the extent there was a risk, it might be worth exploring the possibility of an election. Several requested the ability to have an election whether or not there was a risk of being inadvertently within the regime. The election might take the form of opting in or out; the deadline might be shortly after the time of entry into the capital market arrangement or later, for instance before tax filing deadlines; the election might apply to all sizes of issue or only for smaller ones.

2.41 Various disadvantages to elections were identified, including increased complexity and compliance issues.

2.42 The government's view is that no substantial evidence of an increased risk has been provided and that the disadvantages of introducing an election outweigh any benefits.

2.43 The government therefore does not propose to introduce an election.

Question 8: How and to what extent does uncertainty related to the applicability of the loan capital exemption on the transfer of notes issued in securitisation arrangements increase cost and complexity? To what extent is this a factor in securitisation arrangements being implemented outside the UK?

2.44 Most of the respondents who answered this question thought that uncertainty in respect of the loan capital exemption increases the cost and complexity of securitisation arrangements.

2.45 Several respondents said that achieving as much certainty as possible on tax costs and risk was extremely important. For example, it was mentioned that securitisations involve precisely defined cashflows and that parties such as rating agencies, securitisation trustees and investors simply will not tolerate unexpected costs or expenses, including tax. It was thought that arrangements would not go ahead if a Stamp Duty or SDRT charge would arise on the transfer of notes between investors. It was also mentioned that the note-issuing company may be required to confirm that there is no Stamp Duty or SDRT on the issue and transfer of the notes in the tax disclosure in the Offering Circular or that a similar confirmation may be required by advisers to the note-issuing company in a tax opinion. Obtaining legal and tax advice on the position entails additional transaction costs and there often remains a degree of residual uncertainty and risk, for example because reasonable tax opinion might differ.

2.46 A few respondents mentioned that uncertainty caused by the exception from exemption for results-dependent provisions in section 79(6)(b) of Finance Act 1986 was partly mitigated by the specific saving in relation to some limited recourse provisions under section 79(7B) (see Question 9 below for more detail on this). However, section 79(7B) was regarded as narrow and could be complicated to express in advice to the securitisation parties.

2.47 Some respondents said that uncertainty about the application of the loan capital exemption has led securitisation companies to use workaround processes to remove the possibility of a charge arising if the securitisation is to be UK based. Examples of these processes include the issuing of notes into a clearance or depositary arrangement and applying to HMRC for advance clearance.

2.48 However, respondents were strongly of the view that these processes increase the cost and complexity of arrangements compared to simply issuing loan notes.

2.49 Several respondents thought that whilst uncertainty around the Stamp Duty treatment of notes can cause structuring complications it does not typically drive transactions offshore. However, most respondents who answered the question thought that, while not the only factor leading to securitisation arrangements being implemented outside the UK, it was a factor and did detract from the overall competitiveness of the UK regime.

2.50 The government's view is that the consultation responses indicate that uncertainty related to the applicability of the loan capital exemption on the transfer of notes issued in securitisation arrangements increases cost and complexity and might be a factor in securitisation arrangements being implemented outside the UK. See Question 10 for the proposed government response.

Question 9: What are the characteristics of notes issued in securitisation arrangements which create uncertainty as to whether the loan capital exemption applies to their transfer?

2.51 Most respondents who answered this question thought that loan notes issued as part of securitisation arrangements commonly have characteristics which make it unlikely or uncertain that the loan capital exemption will apply.

2.52 Some respondents mentioned that there was often uncertainty as to whether the loan capital exemption would apply due to section 79(6)(a) of Finance Act 1986 which prevents exemption where the interest rate exceeds a normal commercial return at the time of the transfer.

2.53 Most respondents mentioned that a common characteristic which could prevent relief was a right to interest which is determined by reference to the results of a business or to the value of any property. This would disapply the exemption under section 79(6)(b) of Finance Act 1986.

2.54 Respondents mentioned that the saving provision at section 79(7B) might be sufficient to prevent exemption from being lost in some cases, but is couched in restrictive terms and does not cover the full range of commercial situations which could arise. For example, it does not prevent the excessive interest rate provision of section 79(6)(a) from applying if the interest rate exceeds a normal commercial return at the time of the transfer. In this case, the loan capital exemption would be disapplied.

2.55 One respondent mentioned that the loan capital exemption would not be available for any convertible loans or loans with rights to acquire shares or securities, although they noted that these are not that common in practice in the context of securitisation arrangements. A financing arrangement may involve an equity component, but these will often be separate instruments.

2.56 The government's view is that the consultation responses confirm that there are certain common features of notes issued by securitisation companies which create uncertainty around their eligibility for the loan capital exemption. See Question 10 for the proposed government response.

Question 10: How could the government best address uncertainty about the applicability of the loan capital exemption to the transfer of notes issued in securitisation arrangements? Could updated HMRC guidance provide sufficient certainty?

2.57 All respondents who answered this question thought that it was preferable that uncertainty was addressed through legislation rather than HMRC guidance. Respondents were clear that updated guidance would not provide the required level of certainty and clarity to reassure companies involved in securitisation arrangements, ratings agencies, securitisation trustees and investors.

2.58 Some respondents mentioned that the best option would be amendment of the problematic elements of the loan capital exemption at section 79 of Finance Act 1986 rather than focussing on securitisation arrangements. However, most respondents favoured a clear and targeted statutory exemption from Stamp Duty and SDRT for notes issued in such arrangements.

2.59 Some respondents noted the presence of the unallowable purpose condition within the regime as protecting against avoidance. In their view, any exemption from Stamp Duty and SDRT which applies to securitisation companies would already have this unallowable purpose test built in.

2.60 One respondent mentioned that there was a Stamp Duty and SDRT exemption for hybrid capital instruments. They argued that it was hard to see the policy justification for treating securitisation instruments differently to hybrid capital instruments. The government should therefore introduce a similar exemption for loan capital issued as part of securitisation arrangements.

2.61 Several respondents mentioned that they considered there would be no Exchequer impact if a legislative change was made as no Stamp Duty was currently paid on secondary trading of notes.

2.62 The government's view is that the best way to address uncertainty about the applicability of the loan capital exemption to the transfer of notes issued in securitisation arrangements is through targeted legislation. It is clear from the consultation responses that updated guidance would not provide the level of certainty required. The government considers that addressing issues specific to securitisation arrangements by making more general amendments to the loan capital exemption provisions would give rise to unnecessary additional risk.

2.63 The government therefore intends to introduce an exemption for the transfer of capital market investments issued as part of capital market arrangements by note-issuing securitisation companies. These are the standard notes issued in securitisation arrangements to raise capital.

2.64 The exemption will not generally cover notes which are convertible into other securities, but will cover situations where the notes can only be converted into another capital market investment issued as part of a capital market arrangement by the same note-issuing securitisation company (as these notes would also be exempt).

Question 11: How and to what extent does uncertainty related to the applicability of the loan capital exemption for transfer of pools of loan assets into and within securitisation arrangements increase cost and complexity? To what extent is this a factor in securitisation arrangements being implemented outside the UK?

2.65 Most respondents who answered this question thought that it is difficult to undertake the pre-transaction due diligence exercise necessary to say definitively that all of the loan assets involved qualify for the loan capital exemption. Given the sheer number of assets which tend to make up the underlying asset pool, a review of each instrument to determine whether it falls within the terms of the exemption would be a very costly and inefficient exercise.

2.66 It was mentioned that the only way that confirmation can be given to ratings agencies that no Stamp Duty or SDRT will be payable is by including appropriate assumptions in an opinion. These in turn have to be supported by representations made by a party to the transaction. This can be problematic where the portfolio of assets has been purchased from someone else before it is passed into the securitisation arrangement as there may not be the comfort of representations provided by the person from whom it was purchased. For example, a mortgage portfolio may have been bought and sold several times over the years.

2.67 One respondent mentioned that this was not an issue they had encountered particularly in practice and they would expect clients involved in securitisations to be aware of the general loan terms in any pool of assets being transferred. Other respondents mentioned that standardised assets such as mortgages should clearly fall within the loan capital exemption, although for more bespoke assets such as credit agreements to SMEs, it is necessary to verify the Stamp Duty and SDRT analysis of each asset which adds cost and complexity.

2.68 Respondents were divided over the extent to which uncertainty related to the applicability of the loan capital exemption to transfers of pools of loan assets was a factor in securitisation arrangements being implemented outside the UK.

2.69 Some respondents thought that uncertainty regarding the Stamp Duty treatment of transfers of these types of assets puts the UK at a disadvantage relative to its international competitors. Other respondents recognised that, in contrast to the concern in relation to the transfer of notes issued in securitisation arrangements, uncertainty here does not put UK securitisations in an unfavourable position compared to non-UK securitisations. This is because the Stamp Taxes liability does not depend on the location of the purchaser.

2.70 The government's view is that the consultation responses indicated that uncertainty related to the applicability of the loan capital exemption to the transfer of pools of loan assets into and within securitisation arrangements was not as significant an issue as the uncertainty in respect of transfers of notes issued by note-issuing companies. Uncertainty here does not entail the same level of cost and complexity for arrangements. Also, uncertainty here is not putting UK securitisations at a disadvantage compared to non-UK securitisations and appears not to be a significant factor in arrangements being undertaken overseas.

Question 12: How could the government best address uncertainty related to the applicability of the loan capital exemption to the transfer of pools of loan assets into and within securitisation arrangements? Could updated HMRC guidance provide sufficient certainty? If an exemption is required should there be a value cap on the individual assets and what should that cap be?

2.71 Most respondents thought that statutory exemptions for loan assets acquired by a securitisation company would be a reasonable approach. It was thought that the certainty provided in this way would reduce costs through simplifying the design and operation of the securitisation process. Some respondents thought that there should be a more general Stamp Duty and SDRT exemption for the transfer of loan assets, not just for assets transferred to securitisation companies.

2.72 Some respondents thought that there should not be any Exchequer loss from an exemption for loan assets acquired by securitisation companies as transactions would simply not go ahead if Stamp Taxes were payable. It was also mentioned that land and shares cannot currently be securitised, which are the main classes of asset that attract Stamp Taxes in the UK.

2.73 Several respondents mentioned that anti-avoidance provisions might be used to prevent circumvention of Stamp Duty or SDRT by artificially creating a securitisation arrangement.

2.74 Several respondents thought that there may be merit in a value cap approach where the pool of loan assets consists of a large number of smaller loans and mentioned seeing an increasing number of securitisations of this type, driven in large part by the growth of the non-bank lending market. Other respondents thought that it would be difficult to provide for a cap on individual assets and if protection for the Exchequer is needed it would be better to have an exemption with readily verifiable conditions. This would be most simply done by shifting the focus from the nature of the assets to the acquiror's status as a securitisation company.

2.75 Most respondents thought that updated HMRC guidance would not completely solve the problem. In particular it was emphasised that the key difficulty is a practical one rather than a technical one. The underlying assets would be expected to meet the conditions for exemption. The problem was verifying this.

2.76 Some respondents thought that clarification in guidance may be helpful in part. For example, it was suggested that guidance could confirm that HMRC will not seek to challenge the application of the loan capital exemption to the transfer of loan assets to a securitisation company. Alternatively, guidance could confirm that it is not necessary to analyse each individual loan asset if the typical loan asset would constitute exempt loan capital.

2.77 One respondent mentioned that it would be helpful if it could be confirmed in guidance that bilateral loans were exempt from both Stamp Duty and SDRT by virtue of the non-marketable debenture exemption. Another respondent commented that most of the problem could be solved if the government could clarify that a loan to a partnership which is not a corporate body qualifies as loan capital.

2.78 As discussed in relation to Question 11, the government's view is that the consultation responses indicated that this is not as significant an issue as the uncertainty in respect of transfers of notes issued by note-issuing companies.

2.79 Therefore, the government does not currently intend to introduce an exemption for the transfer of loan assets into or within securitisation arrangements. HMRC will explore further whether updated guidance could be helpful in removing uncertainty in relation to the Stamp Duty and SDRT treatment of transfers of pools of loan assets into and within securitisation arrangements.

Question 13: What are the characteristics of notes issued by ISPVs which create uncertainty as to whether the loan capital exemption applies to their transfer? How and to what extent does uncertainty related to the applicability of the loan capital exemption to transfers of such notes impact commercially on ILS arrangements?

2.80 Respondents who answered this question indicated that there were three main exceptions to the current loan capital exemption which created uncertainty as to whether the loan capital exemption applies to the transfer of notes issued by ISPVs:

I. a right to interest which exceeds a reasonable commercial return (section 79(6)(a) of Finance Act 1986)
II. a right to interest which is determined by reference to the profits of a business or the value of any property (section 79(6)(b)), or
III. a right to repayment which exceeds the nominal amount of the capital and is not reasonably comparable with what is generally repayable under the terms of loan capital listed on the London Stock Exchange (section 79(6)(c)).

2.81 Respondents mentioned that duties on transfer are increasingly a consideration for investors. Most respondents who answered this question thought that the current uncertainty around the application of the loan capital exemption presented the UK in an unfavourable light in comparison with equivalent overseas jurisdictions. Some respondents thought that this uncertainty might put an issuer off choosing the UK as the jurisdiction in which to establish its investment vehicle. Some respondents noted that it is commonplace to seek clearance from HMRC in order to remove uncertainty, adding cost and administrative burden. They also thought that there would be no Exchequer impact resulting from an exemption as no Stamp Duty or SDRT would currently be paid on the secondary transfer of ILS notes.

2.82 Respondents mentioned that the usual workaround for instruments that may not qualify for the loan capital exemption is for the securities to be issued directly into a depositary receipt system or clearance service. Such services are frequently used in respect of ILS that are intended to be traded, irrespective of whether the vehicle itself is established in the UK or offshore.

2.83 However, this was not regarded as a perfect solution. For example, where securities are not intended to be traded between third parties (and therefore not issued into a depository receipt system or clearance service), it is not uncommon for notes to be transferred from one fund to another under common control which creates additional administrative cost and complexity.

2.84 Respondents thought that the need to undertake mitigating action to ensure that a Stamp Duty or SDRT charge does not arise creates an impression to overseas investors that the UK does not have a particularly modern tax regime which encourages inbound investment.

2.85 The government accepts that there are certain common features of notes issued by ISPVs which create uncertainty around their eligibility for the loan capital exemption.

Question 14: How could the government best address uncertainty related to the applicability of the loan capital exemption to the transfer of notes issued by ISPV companies? Could updated HMRC guidance provide sufficient certainty?

2.86 Some respondents considered that there were many situations where the loan capital exemption clearly does not apply. As such, updated guidance would not provide certainty to issuers or investors. One respondent thought that updated guidance might assist if legislative change was not possible but all the respondents to this question thought that a legislative solution was preferable.

2.87 One respondent said that amending the exceptions to exemption in section 79(6) of Finance Act 1986 to make them less restrictive might be the best approach, but most respondents supported a specific exemption for notes issued by ISPV companies. Providing an exemption for notes issued by ISPV companies was regarded as a simple solution, which would reduce cost and complexity and increase the attractiveness of the UK regime.

2.88 The government's view is that that legislation is the best solution. The government therefore intends to introduce regulations exempting the transfer of capital market investments issued as part of capital market arrangements by qualifying transformer vehicles. The exemption will cover the main notes issued as part of ILS arrangements. The exemption will not generally cover notes which are convertible into other securities, but will cover situations where the notes can only be converted into another capital market investment issued as part of capital market arrangements by the same qualifying transformer vehicle (as these notes would also be exempt).

3. Next steps

3.1. As set out in its responses to Questions 2, 6, 10 and 14, the government has decided to introduce secondary legislation:

I. to alter the test of independence for the purposes of the test in Regulation 5(3) that the securities representing the capital market investments must be issued wholly or mainly to independent persons – under the revised test, independence will be tested by reference to control of an entity's affairs through the holding of shares, possession of voting rights, or powers given by articles of association

II. to alter the note issuance threshold in Regulation 5(4) for the total value of the capital market investments made per capital market arrangement – the threshold will be lowered from £10 million to £5 million

III. to provide an exemption from Stamp Duty and SDRT for the transfer of capital market investments issued as part of capital market arrangements by note-issuing securitisation companies and qualifying transformer vehicles.

3.2. The government is publishing on 30 November 2021 two draft statutory instruments, together with draft Explanatory Memoranda, reflecting the decisions outlined above, one in relation to changes to the Regulations and one in relation to Stamp Duty and SDRT, for comment by 10 January 2022.

3.3. As announced at Autumn Budget 2021, the government is legislating in Finance Bill 2021-22 to introduce a power enabling HM Treasury to make Stamp Duty and SDRT changes in relation to securitisation and ILS arrangements by secondary legislation. The measure will take effect from Royal Assent to Finance Bill 2021-22. It is intended that the final statutory instruments will be laid before Parliament shortly after the enabling power in relation to Stamp Duty and SDRT in the Finance Bill comes into effect.

3.4. As set out in the response to Question 4, HMRC and HMT will consult informally on the range of assets which may be securitised, on the activities test as a whole, and on whether the regime is available to the appropriate range of sectors and types of investor, including reflecting on how the Regulations fit with the QAHC regime. This will be carried out in parallel with continued informal consultation in relation to the implication of holding land within securitisation companies. There may then be a second formal consultation.

Annexe A: List of stakeholders consulted

Input was received by way of written responses from and/or participation in virtual meetings and calls with the Securitisation Industry Working Group and the following firms, representative bodies and charities:

ADE Tax
Allen & Overy LLP
Allia C&C, Big Society Capital, the Impact Investing Institute and Social Enterprise UK
The Alternative Credit Council (ACC) and the Alternative Investment Management Association (AIMA)
The Association for Financial Markets in Europe (AFME)
The City of London Law Society (CLLS)
Clifford Chance LLP
Deloitte LLP
Freshfields Bruckhaus Deringer LLP
Grant Thornton UK LLP
KPMG LLP
Linklaters LLP
PricewaterhouseCoopers LLP
Sidley Austin LLP
The University of Buckingham
Willkie Farr & Gallagher (UK) LLP
UK Finance