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

Response to draft legislation and technical note published on 10 December

SLAUGHTER AND MAY

18 February 2015

1. INTRODUCTION

As HMRC and HM Treasury will be aware, one outcome of the *Breedon Report*, published on 16 May 2012, was a recommendation to increase the number of UK-based private placements through an industry-led initiative led by the ACT.

The working group formed by the ACT (of which Slaughter and May was a member) reported its own findings in December 2012. These included the observation that interest paid on bank loans and quoted Eurobonds enjoyed a favourable treatment for UK withholding tax ("**WHT**") purposes and that, in order to encourage the development of a new private placement market, borrowers in that market could be provided with an equivalent position. The working group thus recommended that UK tax law be changed to provide the UK private placement market with a WHT exemption akin to the quoted Eurobond exemption ("**QEE**").

We therefore very warmly welcomed the government's announcement on 3 December 2014 of a new targeted exemption from WHT for interest on private placements. We are grateful to HM Treasury and HMRC for responding to industry's calls for improvements to be made to the WHT rules in order to encourage the growth of a UK private placement market.

However, having reviewed the draft legislation and technical note published on 10 December, we are concerned that the proposed exemption will do little to deal with the potential obstacles to a private placement market that the WHT rules currently impose. In short, it does not go nearly as far as we had originally hoped it would.

In this response to that draft legislation and technical note, we will explain (i) why we consider WHT to be an obstacle to a private placement market, (ii) how the "right" type of exemption would help to overcome these hurdles, (iii) what such an exemption might look like and (iv) why the exemption provided for by the draft legislation and described in the technical note falls short of that.

2. WHY WHT IS AN OBSTACLE TO A UK PRIVATE PLACEMENT MARKET

The UK's WHT regime creates two key obstacles to the development of a private placement market:

i. it restricts the pool of potential investors in privately placed debt; and

ii. it complicates the process of investing and borrowing.

We will explain each of these obstacles in turn.

2.1 WHT restricts the investor pool

Generally speaking, a payment of UK-source yearly interest made by a company, local authority or partnership that is not a bank, building society or deposit-taker will have to be made subject to WHT unless the QEE applies or the recipient of the interest is a bank or building society, is within the charge to UK corporation tax or is resident in a territory with which the UK has a relevant double tax treaty and certain further requirements are met.

Given that a private placement borrower is typically not a bank, building society, deposit-taker, clearing house or registered co-operative or community benefit society, and that privately placed debt is not typically listed, were the typical private placement borrower to make payments of UK-source yearly interest to an investor resident in a territory with which the UK does not have a relevant double tax treaty, a withholding would be required.

Any such investor would insist on receiving the gross amount of interest and for the borrower therefore to pay an additional amount by way of gross-up. But, equally, the borrower would be unwilling to suffer such a significant additional cost. The end result would be that the investor and the borrower would not be able to agree on mutually acceptable terms and the investment would not be made.

This has two important practical implications.

First, it means that the pool of investors that UK borrowers are able to target is restricted – they are unable to borrow from investors resident in territories with which the UK does not have relevant double taxation treaties. There are, of course, a large number of territories with which the UK has such treaties. But there are some notable exclusions from the list – for example, Brazil – and the point is really that the list is incomplete.

This may not be a problem in practice for borrowers in the ordinary bilateral loan market, where the pool of potential lenders is already restricted (essentially to banks), but it is something that could well inhibit the growth of a private placement market, where borrowers would be seeking investment from a wide range of investors.

Secondly, it also means that UK private placements are less attractive to investors in general – even those that happen to be resident in states with which the UK has relevant treaties. Most private placement investors acquire debts on a buy-to-hold basis and do not intend to assign the debt prior to its maturity. But that is by no means always the case. And even where a private placement investor does acquire a private placed debt on a buy-to-hold basis, it will prefer to have the ability to sell or otherwise transfer the debt if for some reason that becomes desirable or necessary in the future.

As noted above, whilst investors will insist on any loan having the benefit of a gross-up clause, the borrower will at the same time be unwilling to suffer such a significant additional cost. As a result, gross-up clauses are generally drafted so that they have effect only to the extent that an assignee of the debt is (in the absence of a change of law), like the original investor, able to receive interest payments free from WHT. This means that if the assignee is resident in a territory with which the UK does not have a relevant double tax treaty, the assignee will receive interest payments net of WHT.

That will be unacceptable to any investor and means that the pool of potential assignees of privately placed UK debt is restricted in the same way as is the pool of original investors. The effect of that is to make such debt less attractive to those investors that are themselves entitled to receive interest payments without WHT, since their ability to assign it (should they ever wish or need so to do) is more limited than it otherwise would be – and it is to be noted also that, for investors in some jurisdictions (e.g. French insurers, we understand), a lack of transferability can cause significant regulatory issues. That either deters such investors from investing in the first place or encourages them to make adjustments to the debt's pricing – both bad outcomes for the borrower.

There is an overlap here with the problem of the conditions imposed by the UK WHT regime complicating private placements even for investors resident in treaty states. We will come onto that presently, but it is to be noted here that this too operates to restrict the pool of potential investors.

2.2 WHT makes borrowing complicated

In order for a payment of UK-source yearly interest to be made without being subject to WHT under the current rules, a number of conditions must be met (assuming that the QEE does not apply). In the case of a private placement – the borrower under which will

typically not be a bank, building society or deposit-taker – the conditions will relate to the identity of the investor and the satisfaction of certain administrative requirements. Either (a) the borrower must reasonably believe that the investor will be within the charge to corporation tax in respect of the interest or (b) the investor must be resident in a territory with which the UK has a relevant double tax treaty and the borrower must be in receipt of a direction from HMRC to pay gross (obtained under the general procedure, the Double Taxation Treaty Passport Scheme or the Syndicated Loan Scheme).

Whilst familiar to UK tax practitioners, including those in the in-house tax functions of large corporate groups, these requirements are not necessarily familiar to borrowers and investors. They need to understand the rules in order to decide whether or not to borrow or invest (as the case may be) and will generally have to take external professional advice in order be in a position to do so. That results in the incurrence of time and expense, which can have a deterrent effect – for both borrowers and investors, particularly at the smaller end of the spectrum.

Experience in the UK shows that the more complexity is involved in a means of raising debt, the less likely a borrower will be to use it: it is not uncommon for the boards (particularly non-executive directors) of smaller corporate borrowers to reject private placements on the basis of complexity, even if the finance director is keen on them; they much prefer the simplicity of bank lending. The WHT regime contributes to this.

Such complexity manifests itself in the drafting of the legal documentation involved in UK private placements, particularly the gross-up clause. As noted above, the lender will always want the protection of a gross-up, but the borrower will want to ensure that it does not have to gross up unless there is a change in law. It is therefore typically agreed that the gross-up obligation will apply only to the extent that the lender (including any transferee) is entitled to receive interest payments free from WHT. And that requires the various conditions required to be met in order for payments to be made without WHT to be set out in the loan agreement, resulting in difficult and complicated drafting – which of course means further time and expense.

Experience of the US private placement market, in which the standard documentation uses includes a very simple gross-up clause that is not suitable for transactions involving UK borrowers, shows that this can prove to be a real problem in practice. Indeed, UK private placement borrowers operating in the US market have in some cases been forced to adopt unusual behaviour in order to have the UK WHT rules accommodated by investors unwilling to deviate from market documentary norms – such as issuing the private placement out of a company resident in a territory which does not impose withholding on private placements and then having a captive quoted Eurobond between that company and the “real” borrower.

The UK WHT regime is, of course, also in point in relation to ordinary bilateral loans and the market norm is for bilateral loan agreements to include complicated provisions dealing with the circumstances in which interest payments will be made gross. That is generally acceptable to the parties: the lender will typically be a bank and familiar not only with the UK WHT regime but also the relevant contractual provisions; and the borrower will either have little choice but to accept the provisions in any event or will simply take comfort from the exclusion for payments of interest to banks. But the participants in private placements are potentially very different and both the investor and the borrower could be unfamiliar with the UK WHT regime.

3. WHAT THE RIGHT SORT OF WHT EXEMPTION WOULD ACHIEVE

There is considerable scope for an appropriately drafted WHT exemption to improve the existing situation and thereby help achieve the government's aim of increasing the use of private placements, particularly among smaller businesses. It would do so by resolving the problems outlined above.

Were a WHT exemption for private placements to apply to payments of interest made to *any* investors, that would resolve the problems associated with the current regime's restriction of the pool of investors to which private placements can be effectively marketed. Borrowers would have a wider choice of potential investors and investors would have fewer concerns around transferability, resulting in more private placements by, and potentially better terms for, UK borrowers.

We note in this regard that widening the field of potential private placement investors is a key objective of industry at the European level. That objective is unlikely to be achieved at that level in the absence of significant steps towards a European capital markets union, which would of course require fundamental changes in national practices and national insolvency laws. It nevertheless demonstrates, however, that there is appetite across Europe for a market in which issuers are able to target investors from all jurisdictions. A UK WHT exemption for private placements could, if drafted so as not to restrict the pool of investors that UK borrowers are able to target, help make the UK a hub for such a European market – and thus attract to the UK all of the ancillary economic benefits that could be expected to flow from its presence here.

Were a WHT exemption for private placements to be very simple, it would also resolve the problems associated with the complications involved in the current regime. An exemption that was not only capable of being quickly and easily understood by borrowers and investors, but removed the need for complicated legal provisions to be included in the relevant documentation, would reduce the costs involved in private placements and help make them less likely to be regarded as an overly complicated form of debt finance (particularly among smaller business). Private placements would thus be made more accessible and attractive.

Some UK borrowers are already raising debt through the US private placement market. Others are not doing so because there are too many hurdles to jump over in order to access that market. A key motivation in developing a UK private placement market is to make it unnecessary for UK borrowers to use the US market and to encourage those borrowers not currently in a position to use private placements at all to begin doing so. Reducing the amount of complexity involved in private placements is important in this regard.

4. WHAT THE RIGHT SORT OF WHT EXEMPTION WOULD LOOK LIKE

As noted above, the December 2012 report of the ACT working group commissioned by the *Breedon Report* recommended a targeted WHT exemption to put private placements on the same tax footing as bank loans and quoted Eurobonds. More specifically, it recommended an exemption "akin to the Quoted Eurobond Exemption".

An exemption akin to the QEE is exactly what the "right" sort of private placements exemption would look like.

Both of the two key obstacles to the development of a private placement market identified above – restrictions on the pool of potential investors and complications involved in the process of investing and borrowing – arise essentially from the same problem. That is the need for conditions relating to the *investor*

to be satisfied in order for payments of interest on private placements to be paid without being subject to WHT.

Currently, the key investor-related condition is the requirement for the investor to be either within the charge to corporation tax or resident in a treaty state. As explained above, that means that borrowers cannot target certain investors, that transferability is restricted, that private placements are difficult to understand and that the relevant documentation is complicated. But the same problems would arise from any conditions relating to the investor: it is not the specific nature of the current conditions that is the problem; the problem is that the conditions relate to the investor.

The QEE, on the other hand, has no investor-related conditions. Thus, (i) interest on quoted Eurobonds can be paid without WHT, irrespective of the identity or attributes of the investor, meaning that they are potentially accessible to all investors, (ii) quoted Eurobonds can be assigned without concerns in relation to WHT, (iii) the application of the UK WHT rules to quoted Eurobonds is very easy for both borrowers and investors to understand and (iv) the documentation connected with quoted Eurobonds is relatively simple (at least in relation to WHT).

In order for a UK WHT exemption to follow the recommendation of the ACT working group and achieve the government's objectives, it should therefore follow the QEE in avoiding investor-related conditions.

5. THE KEY FLAW IN THE CURRENT PROPOSAL: INVESTOR-RELATED CONDITIONS

The proposal, as set out in the draft legislation and the technical note, imposes three important conditions in relation to the investor:

i. it must be not be connected with the issuer;

ii. it must be a "UK-regulated financial institution" (or a foreign equivalent); and

iii. it must be resident in a territory with which the UK has a double taxation treaty with a non-discrimination clause.

In addition, the proposed anti-avoidance rule described in the technical note would impose a fourth investor-related condition if, as suggested, it required the debt to be "held" for genuine commercial reasons.

If the exemption is enacted with these conditions included, we fear that it will do very little to help resolve the problems identified above and thus achieve the government's aim of encouraging the use of private placements. The pool of potential investors and assignees will continue to be restricted to investors resident in territories with which the UK has relevant double taxation treaties, borrowers and investors will continue to have to grapple with complicated rules to determine whether or not payments can be received gross (for example, investors will need to be educated about the effects of their circumstances changing) and the legal documentation will remain difficult as a result of having to factor in the investor-related conditions for exemption.

The proposal attempts to deal with some of the practical difficulties associated with investor-related conditions by having these certified by the investor itself – the thinking presumably being that it would be unreasonable to expect the borrower to determine the investor's status in various respects. However, it is the very existence of investor-related conditions – not how they are assessed – that is the problem.

Take, for example, the fact that one of the key problems with the existing WHT rules is that they result in overly complicated documentation that operates in practice to make UK private placements

less attractive than they might otherwise be. If the borrower has to determine whether the investor is resident in a treaty state, it will want confirmation of that from the investor, which will require the inclusion of contractual provisions dealing with that and require the investor to understand why it is being asked to confirm its tax residence. If, on the other hand, the burden of demonstrating that the investor is resident in a treaty state falls on the investor by virtue of its having to certify its treaty residence in order for the exemption to apply, the documents will have to deal not only with what happens if the investor fails so to certify but also what will happen if the debt is assigned – requiring just as much complexity of drafting.

The fact that, for good reasons, the proposal also includes a look-through feature is also a potential problem, particularly given the investor-certification rule. Depending on how the feature was implemented, certain investors – particularly investment funds – would have to ask potentially difficult questions of their holding structures. This would only add to the complexity of applying the exemption and again dilute any benefits the exemption otherwise had in making UK private placements more attractive.

On that basis, we strongly recommend that HMRC and HM Treasury reconsider the inclusion of investor-related conditions and recast the exemption so that it is closer in approach to the QEE.

6. COMMENTS ON OTHER CONDITIONS

6.1 Requirement for the issuer to be a company

Private placements are not used exclusively by "ordinary" corporates. Issuers in the US market include, for example, UK housing associations (for example, First Wessex Housing Association recently entered into a private placement) and universities (the London School of Economics and various Cambridge colleges are private placement borrowers).

These more unusual types of issuer will not necessarily be organised naturally as companies for UK tax purposes. Whilst it may be possible for them to incorporate a company to act as the borrower, it should not be assumed that this will be possible in all cases. And even if it is possible for them to incorporate a company to act as the borrower, this will carry with it administrative costs that will leave these issuers at a potential disadvantage.

We would therefore prefer to see an exclusion limited to individuals, so that any type of borrower other than an individual is potentially able to benefit from the exemption.

6.2 Requirement for a "security"

"Security" is not defined in the draft legislation. We assume, however, that the intention is for it to include only bonds and not simply loans.

It is, however, envisaged that the UK private placement market will involve both types of arrangement. Indeed, a loan arrangement is favoured by the single biggest participant in the private placement market and the Loan Market Association has prepared standard market documentation for UK private placements (adaptable generally for European use) using the form of either a loan or a bond.

We would therefore like to see the exemption apply to loan arrangements as well as to bonds, in order for as many private placements as possible to benefit from it and to ensure that WHT is not a factor in the decision as to which structure to use. We fear that were the exemption to apply only to private placements structured as bonds, borrowers that would otherwise prefer to use loans will be forced to issue bonds and that this would have a distortive effect.

6.3 Requirement for minimum three-year maturity

Given that debt with a term of less than a year does not attract WHT (as interest paid on it will not constitute yearly interest unless the debt is capable of renewal), it appears that only private placements with a maturity of 1 to 2.99 years would be outside the scope of the proposed exemption.

Although private placements in the US market typically have maturities of between 3 and 30 years, we see no reason to restrict a UK WHT exemption to such debts. We would prefer to see the exemption apply instead to any private placement with a term of a year or more, so that the private placement of any debt currently within the scope of the UK WHT regime could be made more attractive. Indeed, there would in that case be no need for a maturity-based condition at all, since debts not carrying yearly interest would be outside the scope of the WHT regime in any event – which would also be an attractive outcome as it would further simplify the exemption.

We note in any event that the current drafting of the condition is deficient in that it requires the terms of the debt to "not provide for the loan relationship to terminate within 3 years of its coming into force". The documents providing for any commercial loan relationship – whatever its intended maturity – can be expected to include provisions requiring early repayment in certain circumstances, for example upon the occurrence of an event of default or the loan becoming illegal under applicable law. Such documents can therefore be regarded as "providing for the loan relationship to terminate within 3 years of its coming into force" and as therefore falling foul of the draft legislation.

If a maturity-based condition is (contrary to our preference) to be included in the legislation, a carve-out should therefore be included to deal with these circumstances of repayment, perhaps along the lines of section 431 ITTOIA 2005 (excluded occasions of redemption in relation to deeply discounted securities).

We note in addition that it is common practice in the US market to allow the issuer to prepay the debt at any time (provided that it prepays the par value plus a "make whole" amount calculated using a formula based on the net present value of future interest payments), that the documentation of loans in general frequently allows the issuer to prepay the debt in the event of a change of law that would require the borrower to gross up its interest payments for tax, and that the standard documentation for private placements drawn up by the Loan Market Association also provides for this. If a maturity-based condition is to be included in the exemption, we would therefore also like to see the carve-out described above extend to redemptions at the option of the borrower.

The preference for private placements of any maturity to benefit from the exemption and the need for any maturity-based condition to be qualified by potentially complicated carve-outs such as these perhaps lean in favour of removing the maturity-based condition altogether.

6.4 Requirement for the issuer to be a trading company

As a general matter, we would prefer it if this condition were removed. This is because we envisage private placements potentially being used not only by traders but also by genuine commercial enterprises that do not undertake activity that can be regarded as trading activity for UK tax purposes.

We are also concerned that any condition based on the concept of trading would necessarily be susceptible to the issues connected with it. For example, a person can in certain circumstances be treated as ceasing to trade upon falling into financial difficulty. Such a person may have raised debt through a private placement. It is not impossible that its creditors would agree

to renegotiate the terms of the debt funding rather than call an event of default and demand repayment. However, the prospect of the borrower's position improving would be made more remote if, as a result of its being deemed to have at some point ceased to trade (for example, while it restructured its business), the borrower's interest payments ceased to fall within the private placements WHT exemption and it was suddenly forced to start grossing up its payments to its lenders.

If it is considered essential to include a trading-based requirement, the exemption will need to be drafted carefully to deal with situations such as these.

We note in this regard that the technical note suggests that any trading requirement would be based on the equivalent test under the rules governing the substantial shareholding exemption (SSE) in the chargeable gains code. This is a cause of potential concern and we wonder if the SSE test is the right one to use.

One of the major difficulties encountered by taxpayers and tax practitioners in applying the SSE rules is that they require an assessment of whether the companies or groups in question are carrying on non-trading activities to a "substantial extent". Whether the "substantial extent" test is met is by no means always obvious. Some companies and groups, particularly those carrying on different types of business, may be close to the line and testing the position can be a significant exercise, involving considerable time and expense. Also, larger corporate groups very often feature intra-group loans channelled through dedicated financing subsidiaries (supporting sales of the group's products), which can very often complicate the analysis by adding to the group's non-trading activity, despite it clearly being, in reality, a trading group.

It seems to us for these reasons that, if (contrary to our preference) issuers are to be required to be trading companies in order to benefit from the exemption, a test of trading more simple than the one used in the SSE rules would be more appropriate. We would be pleased to explore the possible alternative approaches with HMRC and HM Treasury.

In any case, the proposal should be drafted to make it clear that any trading-based test is a group-wide one and not specific solely to the issuing entity. The technical note suggests that the issuer itself would have to be a trader. This is alarming, as the issuer of privately placed debt will very often be an otherwise passive holding company of a trading group or the group's non-trading finance subsidiary and thus regarded for general tax purposes as an investment company.

We would also prefer to see any such test take the form of a "day-one" test, with the condition having to be met at the point of issuance and not having to be satisfied whenever a payment is made or otherwise from time to time. If borrowers are required continually to assess whether they satisfy the condition in order to ensure that the WHT exemption still applies, any borrowers close to the line (perhaps because they have a number of different businesses, some trading and some not) would be left with no practical choice but to incur potentially considerable costs in monitoring the position.

Another problem with any trading-based test's not being assessed only at the point of issuance is that the circumstances of the issuer and its group may change for only reasons outside of its control, but without affecting the substance of the arrangement. For example, the issuer (or its parent) may be the subject of a takeover, such that it becomes part of another corporate group. Were the issuer's ability to pay interest on its privately placed debts without WHT to be dependent on its satisfying a trading test based on the SSE rules, the takeover could result in the issuer's being regarded as substantially non-trading and having to begin grossing-up interest payments.

The prospect of that happening could, indeed, have an unintended distortive effect on the issuer group's value to a potential acquirer.

6.5 Maximum/minimum issuance condition

It is not clear from the Technical Note whether the thresholds in this regard would apply by reference to each *issuance* or to each *issuer*. However, it has been suggested to us that HMRC and HM Treasury intend them to apply to issuances (so that whilst each privately-placed debt will have to have a principal amount falling within the accepted range, a single issuer could, for example, have any number of individual debts at the top end of the spectrum without ceasing to be able to benefit from the exemption in respect of interest payments on each of them).

If that is indeed the case, we imagine that the secondary legislation supporting the exemption would have to include rules grouping issuances by a single issuer that were connected closely in time (to stop a borrower circumventing the upper threshold by splitting an issuance of debt in excess of the upper threshold between smaller debts issued on the same or consecutive days). We would be interested to see and to discuss how that would be framed. For example, would a number of issuances below the lower threshold by the same borrower in a short space of time be able to be grouped together for the purposes of testing the exemption? And how close in time would individual issuances have be to each other in order to be grouped?

Additionally we would be interested to see how the test would apply to an issuer wishing to reopen, and issue further debt, under an existing placement – for instance, through a tap issuance or the equivalent of a trombone mechanism. Would the threshold apply to the total amount of debt issued under the placement (i.e. the existing borrowing and the additional borrowing)? Or would the threshold apply afresh only to the additional debt?

We also imagine that such rules would have to include provisions applying the threshold test on a group-wide (or connected company) basis, both to prevent the thresholds being circumvented by issuer groups splitting issuances across several companies and to ensure that issuer groups are not prevented from spreading their issuances across a number of entities for genuine commercial reasons (for example, to allow distinct businesses to be funded independently). Again, we would be keen to see and discuss the detail of such provisions. How would joint ventures be dealt with, for example?

Similar issues would arise were the thresholds instead to apply to issuers rather than issuances (so that the exemption would not apply to the extent that the aggregate amount of a borrower's privately-placed debt exceeded the upper threshold, for example). Again, would the test be on a group-wide basis (so that in determining the aggregate amount of relevant debt, private placements by all connected persons would be taken into account)? And how would joint ventures be dealt with?

In terms of the threshold levels, we do not consider £300m to be an exceptionally low ceiling in terms of current behaviour among UK issuers. The principal amount of privately placed debt issued by most participants in the market at present falls below the £300m threshold. However, it is to be noted that some issuers and groups have issued debt in excess of £300m in the US market (albeit spread across several separate issuances). For example, Smith & Nephew, the medical equipment manufacturer, privately placed $800m of debt in October 2014. So whilst £300m is not an exceptionally low threshold, nor is it an extravagantly high one.

We believe an important question in the setting of any thresholds here to be one of how ambitious

the government wishes to be in relation to the development of a UK private placement market. The US market sees placements of up to $1.5bn (roughly £1bn). And in the German Schuldschein market, the car parts manufacturer ZF Friedrichshafen last month privately placed a debt of €2.2bn (£1.65bn). In order to develop a UK market that can compete with markets in other jurisdictions, we would like to see the UK's WHT exemption for private placements extend to a much higher amount, or to be potentially unrestricted (for example, a default threshold could be set but HMRC could be given the freedom to grant exemptions to private placements of larger amounts if requested to do so). That would also help to attract larger corporates to the market, which can be expected to have a knock-on effect of opening it up to smaller borrowers.

At whatever level the threshold is set, we note that the technical note does not make it clear what the consequence will be if the upper threshold is exceeded. Would interest on the whole debt fall outside the exemption or would interest only on the excess fall outside? In our view, only the part of any interest payment attributable to the part of the debt falling above the upper threshold should be disqualified; the upper threshold should not represent a cliff edge. This approach would allow issuers to raise additional debt in a potentially non-exempt way should they wish to do so, without losing the benefit of the exemption on debt falling below the threshold.

We also note that the secondary legislation will need to include provisions dealing with foreign exchange risk if the thresholds are set in sterling (so that, for example, interest on a euro-denominated placement with a principal amount the sterling equivalent of which is, at the date of issue, equal to the upper threshold can continue to benefit from the exemption even if the euro appreciates against sterling). In addition, we would like the secondary legislation to make it clear that the upper threshold applies to the outstanding principal and not simply to all outstanding amounts, so that the accrual of unpaid interest does not become a problem for borrowers in financial difficulty (whose plight would otherwise be worsened if they had to gross up payments as a result of the exemption's falling away).

7. CLOSING REMARKS

Our response to the proposed WHT exemption may be summarised as follows:

i. the proposal of a WHT exemption for private placements is very welcome and we commend the government, HM Treasury and HMRC for listening to industry's calls for help in developing the UK market;

ii. however, we are concerned that the investor-related conditions appearing in the current proposal would, if enacted, prevent the exemption from achieving its intended aims; and

iii. we also have certain concerns with some of the borrower – and debt-related conditions provided for in the current proposal.

We acknowledge that creating an exemption of this sort from scratch cannot be easy and that it may be that HM Treasury's and HMRC's mandate from the government makes the task less straightforward than it might otherwise be. We suspect that the government has charged HM Treasury and HMRC with creating an exemption for interest on private placements that does not operate to exempt interest on other arrangements. The natural starting point is then to ask what a private placement would ordinarily look like and from there to craft an exemption based on conditions that could be met only by an arrangement meeting that description – in effect, to create a statutory definition of a private placement and base the exemption on that.

It seems to us that that approach has led to the difficulties we have identified. Characterising private placements in part by features relating to the investor, for example, inevitably leads to the inclusion of investor-related conditions. The problem is that, however accurate the starting definition may be, working from that basis will not necessarily produce an exemption that will in practice be effective to realise its fundamental aims. It is also an inflexible approach that is difficult to adjust to changes in the market (that is, to developments in what UK private placements look like).

There are alternative approaches. One example would be to start with a general exemption covering interest of any arrangement and then narrow that to exclude the arrangements that the government does not wish to exempt. That is, whereas the current proposal appears to stem from an attempt *positively* to identify the key features of a private placement, this alternative approach would be a *negative* one of identifying the features of debt arrangements that the government does not wish to exempt. Whether that is a workable approach depends, however, on exactly how far the government is willing to go and how much room for manoeuvre HM Treasury and HMRC have.

Whatever the approach adopted, we believe there to be ways of developing an exemption that not only achieves the government's policy aims but also works within the confines of the relevant legislative mandate. We have a number of ideas that we would very much like to share with HM Treasury and HMRC in that regard. However, we feel that it would be inappropriate to offer a proposed exemption of our own in this letter, as we suspect that we are not fully aware of all of the restrictions in which the exercise must operate.

Rather, we would like in the first instance to meet with HM Treasury and HMRC to discuss the wider context, the government's objectives and the available scope for drafting. Having done so, we would like to work together with HM Treasury and HMRC to develop an exemption that satisfies the aims both of the government and of industry and will operate in practice to remove the barrier to the development of a UK private placement market that WHT currently presents, giving UK borrowers easier access to UK and overseas investors.

The Association of Corporate Treasurers

The Association of Corporate Treasurers (ACT) is the leading professional body for international treasury operating in the public interest under Royal Charter. We provide the widest scope of benchmark qualifications for those working in treasury, risk and corporate finance. Membership is by examination. We define standards, promote best practice and support continuing professional development. We are the professional voice of corporate treasury, representing our members.

Our 4,400 members work widely in companies of all sizes through industry, commerce and professional service firms.

We canvas the opinion of our members through meetings, seminars and conferences, webinars, our monthly e-newsletter to members and others, The Treasurer magazine, topic-specific working groups and our Policy and Technical Committee.

For further information visit www.treasurers.org

Guidelines about our approach to policy and technical matters are available at http://www.treasurers.org/technical/manifesto.

Slaughter and May

Slaughter and May is a leading international law firm recognised throughout the business community for its commercial awareness and commitment to its clients. We work in partnership with our clients, anticipate their business needs and offer solutions. Central to our culture is the priority we place on the individual needs of our clients and our commitment to delivering a client rather than product focused service. We have an excellent and varied client list that includes leading companies, organisations and governments.

We have a strong partnership based on mutual trust and respect, which extends to all our staff and clients. We achieve excellence through collective effort, mutual support and a willingness to share expertise.

For further information on who we are and what we do please visit our website at www.slaughterandmay.com.

© Slaughter and May 2015

This material is for general information only and is not intended to provide legal advice.
For further information, please speak to your usual Slaughter and May contact.