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Dear Mark

Qualifying Private Placement Regulations 2015/2002: Lender Assignments

As you will recall, the Commercial Real Estate Finance Council Europe (**CREFC**) was one of the organisations invited to participate in a consultation on the proposed qualifying private placement exemption from withholding during 2015. As a stakeholder in that consultation, we provided comments on drafts of the regulations to be made under section 888A Income Taxes Act 2007 (**ITA**) and the proposed draft guidance on this new withholding exemption.

The Qualifying Private Placement Regulations 2015/2002 (the **Regulations**) came into force on 1 January 2016. The draft guidance has now been incorporated into HMRC's Saving and Investment Manual (**SAIM**).

Further to our recent telephone call, we are writing to you because of a particular concern raised by some of our members as to how the Regulations apply where a creditor transfers its interest in a loan.

We set out below the issues involved and would be grateful for your views. Given that this is a general query made by a trade association, rather than a specific request for clearance in relation to a particular transaction, we acknowledge that your reply would be on a non-reliance basis. Therefore the reason for raising this with you is to ask you to consider addressing this particular issue within HMRC's guidance on the QPP exemption (and, if required, amending the Regulations) by adding a section on assignments.

That being said, we would be looking to share any reply you give with our interested members (this would be done privately - and in particular we would not be publishing the correspondence on our website). As above, this would be for information only.

The issue

Under section 888A ITA, a "qualifying private placement" is defined as "a security" which represents a loan relationship to which a company is a party as debtor, is not listed on a recognised stock exchange and meets certain other conditions (as set out in the Regulations).

The conditions set out in the Regulations apply to a "relevant security" which is defined in Regulation 2(1) as "a security or a loan relationship". We understand that, following initial discussions with stakeholders in July 2015 on a first draft of the Regulations, this definition was included to clarify that "security" within section 888A bore its wide tax meaning and in particular included loans. (Similarly HMRC removed from

both section 888A and an earlier draft of the Regulations references to a security being "issued" - save in Regulation 2(2).)

The potential application of the QPP exemption to loans, as well as to "pure' securities (as understood in the capital markets sense) is also reinforced in the guidance at SAIM9320.

The conditions as set out in the Regulations include that:

(a) the relevant debtor holds a creditor certificate for *each* creditor (see Regulation 3(1)(b)); and

(b) Condition B in Regulation 4 (that at the time the relevant security was entered into, it had a minimum value of £10 million; or, where it had a lower value at that time, it was comprised in a single placement with other relevant securities to the same debtor that had a minimum value of £10 million).

This letter concerns how these two conditions apply where a creditor transfers its interest in a loan to a new lender as described below, - and, in particular, the extent to which a person that acquires an interest in a loan from the original creditor can rely on the QPP exemption. Similar issues could apply where the borrower issues notes (what the market would call a 'security'). This is because a note holder may transfer part of its holding only, which may mean (depending on denominations) a "single" security is effectively split to create two notes. In practice however it is much more likely to be an issue in relation to loans.

The issue relates to how "relevant security" is to be interpreted in this context. This issue is relevant at any time the loan to which the debtor is party has more than one creditor, but particular concerns arise where an additional creditor becomes party to a loan because of a transfer by an existing creditor of all (or part) of its commitment.

Although this letter concerns any transfer by a creditor, this issue is particularly relevant to syndicated loans. In a syndicated financing, the original lender (often, but not always, a bank) will look to sell-down to third parties - and the loan entered into on the understanding that this is likely/intended to happen.

Here, HMRC's guidance at SAIM9310 states that:

> "Private placements are a form of unlisted debt. They are commonly defined as securities that are placed privately rather than through a public offering, but are also understood to include any kind of non-bank business lending placed directly with investor."

A syndicated loan is a form of unlisted debt. Syndication can lead to the loan being placed with investors that could qualify for QPP - but the loan may not be placed "directly" with them. However, as we noted previously in our comments on the draft guidance, section 888A Finance Act 2015 defines "qualifying private placement" by setting out the gateway conditions - and does not itself reference (or define) a "placement" as such. As a result, subject to the technical issues below, it seems that the QPP exemption would be available to a person that acquires an interest in a loan as a result of syndication: but it would be useful if the position in relation to syndicated loans could be addressed specifically in the guidance (in addition to any general commentary on transfers to a new creditor).

The meaning of "relevant security"

Under s888A ITA, a qualifying private placement is defined as meaning a "security which represents a loan relationship to which a company is a party as debtor" that meets certain conditions. The conditions as set out in the Regulations reference the "relevant security" - which is defined in Regulation 2(1) as a security or a loan relationship.

Where a loan is made by two or more lenders (L1 and L2), the debtor (B) is party to two different (debtor) loan relationships - one with L1 in the position of creditor and one with L2 (this follows on from s302

Corporation Tax Act 2009). We assume it is intended that this means that there are two relevant securities comprised within the loan - and that the conditions in the Regulations have to be applied to each individually: **is this correct?**

The definition of "creditor" within the Regulations is, "in respect of a payment of interest on a relevant security, the person who is beneficially entitled to that interest". Therefore each of L1 and L2 is a creditor in respect of the relevant security to which it is party.

Under Regulation 3(1)(b), for a relevant security to be a qualifying private placement, B must hold a creditor certificate "for each creditor" under that relevant security.

Here, "each creditor" relates to the relevant security (and not to any broader arrangement of which it is comprised). So, as long as the conditions are met by reference to L1's relevant security (i.e. that part of the loan in relation to which L1 is creditor), L1 can benefit from the QPP exemption - even if L2 does not provide a creditor certificate to B. We note that this issue is partially addressed in SAIM9350 which indicates that a placement can consist of more than one security (but, as set out below, we consider that the importance of clarity on such a key aspect of the provisions means that the guidance on this should be expanded).

This construction also makes sense in the context of what we understand was the rationale for adding "each creditor" to Regulation 3(1)(b). This was explained in an email from HMRC to stakeholders on 15 December 2015:

> "The changes reflect the fact that *each private placement can be made up of separate relevant securities which have the same debtor (demonstrated by Regulation 4(3)(b)). These relevant securities are separate loan relationship*s. In order to qualify for the exemption, the debtor needs a certificate for each creditor under the relevant security, not for each creditor under the private placement. So, for example, the fact that a private placement includes a Cayman creditor alongside others, doesn't mean the exemption is prevented from applying to all interest payable on the placement. There may be exempt relevant securities included in the placement. *In fact it is hard to imagine a commercial scenario where a relevant security would have more than one creditor,* but we needed to include this possibility in the drafting, which is why Regulation 3(1)(b) and 3(1)(d) have been amended." (emphasis added)

Although, as above, we note that SAIM9350 is intended to cover this particular issue, it would be helpful if HMRC's view that, in the context of a loan, each 'day one' creditor is looked at on a stand-alone basis, could be confirmed expressly within the guidance. We consider SAIM 9350 could be usefully expanded (perhaps along the lines of this earlier email and including an example to illustrate how this applies in practice). The reason for asking is that some members have told us of concern that "each creditor" in Regulation 3(1)(b) could be construed as requiring all 'day one' creditors under a single loan agreement to provide creditor certificates for the QPP exemption to be available (which your email above demonstrates is not the intention).

A possible example could be a loan (£20m) with three initial lenders: L1 (£10m), L2 (£4m) and L3 (£6m). L1 is a UK company; L2 is a Cayman company and L3 is a treaty-protected non-UK company. If L3 provides a creditor certificate, the QPP exemption will apply to payments of interest to it, notwithstanding that neither L1 nor L2 can provide such a certificate. The example could also be helpfully contrasted with the position if L3 was a non-UK partnership (and all its members were treaty-protected non-UK companies): here we assume that the relevant security is the loan relationship to which L3, as a firm, is party and that Regulation 3(1)(b) requires each partner/beneficial owner to provide a creditor certificate in order that the QPP exemption applies to payments of interest to L3: see SAIM9360.

Transfer of loan by creditor

For these purposes, assume the following fact pattern as at day one. The remainder of this letter then considers the implications and treatment of three alternative loan transfer scenarios.

- An original lender (**L**) makes a loan of £20m to the debtor (**B**) in June 2019 with a ten year term. Interest is payable quarterly and the first interest payment date is September 2019.

- L does not provide a creditor certificate (whether because it is not eligible to do so or because a different exemption from withholding is available). This could be the case for example because L is within the charge to corporation tax or has the benefit of a DTTP passport.

- Therefore, as between L and B, the loan is not a "qualifying private placement" because Regulation 3(1)(b) is not met. L then transfers (all or part) of its loan to a new lender (NL) in October 2019. That transfer is (in relation to scenarios 1 and 2 below) by way of assignment or (in relation to 3) by novation.

(Although the scenarios address the position where a creditor transfers an interest in the loan within a few months of the loan being advanced, the same analysis applies (a) if, say, the transfer did not take place until 2025 (i.e. nearly 6 years after the loan was originally advanced) or (b) should NL subsequently transfer all or part of its interest in the loan to a new lender (NL2) in, say, 2023.)

Scenario 1: L assigns all its interest in the loan to NL

As a result of the assignment, NL acquires the same rights that L had in the loan: NL is party to the same loan relationship as L was party to. From B's perspective the only difference is the identity of the creditor. Therefore, NL clearly becomes creditor in respect of the same "relevant security" that was held by L.

NL provides a creditor certificate to B.

In terms of the conditions:

(i) the debtor and listing conditions continue to be met;
(ii) the condition in Regulation 3(1)(c) is determined at the time the relevant security was "entered into" by B - and so as at June 2019;
(iii) NL has acquired the entirety of L's loan and so the "relevant security" as between NL and B met Condition B in Regulation 4 at issue;
(iv) Condition A in Regulation 4 also met; and
(v) the only creditor of the relevant security following the assignment is NL: provided B reasonably believes that NL is not a connected person and holds a valid creditor certificate from NL, the remaining conditions in Regulation 3(1) are met.

Therefore, although the loan when made by L was not a qualifying private placement, it is a qualifying private placement when NL becomes creditor. Interest can be paid to NL without withholding under the QPP exemption. **Do you agree that this is how the legislation applies?**

Scenario 2: L assigns part of its interest in the loan (say £5m) to NL

Following this partial assignment, the loan has two creditors - L as to £15m and NL as to £5m. NL provides a creditor certificate to B.

As far as B is concerned, its accounts would show it as party to a single debt liability of £20m, without differentiating between creditors.

In terms of the conditions, the debtor and listing conditions continue to be met.

In terms of the other conditions, the issue is how "relevant security" is to be construed. "Relevant security" is defined as a security or a loan relationship. From June 2019 to October 2019, B is party to a single loan relationship. The assignment by L is a related transaction of part of that loan relationship. After the assignment, there are two creditors - and, as a result, given the structure of Part 5 CTA 2009, there are then two loan relationships (even though B's accounts would show one liability only).

We assume it is intended that this means that there are two different relevant securities as a result, and that the conditions in the Regulations have to be applied to each - notwithstanding that there was a single relevant security (the loan relationship with L) at the time the loan was originally advanced: **is this correct?**

In this case, although the £15m held by L cannot be a qualifying private placement, the £5m held by NL could be (and so NL can benefit from the QPP exemption).

(This is because of how "creditor" is defined in the Regulations: namely, "in respect of a payment of interest on a relevant security, the person who is beneficially entitled to that interest". Therefore provided the £5m loan owned by NL is a "relevant security", only NL is the creditor of that security.)

We assume this is how the Regulations are intended to operate: this is because the QPP exemption is an exemption from withholding tax and as a result whether or not the exemption is available must be tested each time there is a payment of interest. This means that, at each interest payment date, you look to the loan relationship(s) to which the debtor is party - and test the conditions by reference to each such loan relationship (and the person that is creditor under that loan relationship) separately.

This construction also makes sense in the context of what we understand was the rationale for adding "each creditor" to Regulation 3(1)(b) as explained in the email from HMRC to stakeholders on 15 December 2015 referenced in "The meaning of "relevant security" above".

On that basis, following the assignment, there are separate loan relationships - and as a result it seems that each should be seen as a separate relevant security (with the entirety of the loan - i.e. comprising both L and NL's individual commitments - being the placement of which each relevant security forms part). On this basis, L and NL are in the same position they would have been in had they co-lent to B in June 2019.

However, certain of the conditions (in particular Regulations 3(1)(c) and 4) require eligibility for the QPP exemption to be tested by reference to when the "relevant security" was entered into. As a result, we understand that there are concerns about how these apply given ambiguity within the Regulations relating to how "relevant security" should be construed in this context. In particular, if only the original loan (£20m) can be the relevant security for these purposes, as L has not given (and perhaps cannot give) a creditor certificate, the loan cannot be a qualifying private placement - as B will not hold a creditor certificate for each creditor in relation to that relevant security.

Below we consider these two conditions in turn:

Regulation 3(1)(c)

The condition here is that the "relevant security" was entered into by B for genuine commercial reasons, and not as part of a tax advantage scheme.

From B's perspective, it entered into a single loan (and a single loan relationship) of £20m in June 2019 with L. It did not then enter into two loans, one with L and one with NL (as there was no separate relevant security at that date in relation to NL's £5m commitment). The assignment to NL does not affect the timing of when B entered into that loan relationship.

B entered into that £5m 'part' of the original loan (that is now held by NL) in June 2019.

Therefore, it seems that this condition can apply by reference to when that £5m commitment was originally entered into in June 2019, notwithstanding it did not exist as a separate relevant security at that date.

This means however that although the "relevant security" in relation to payments to NL is the £5m, the condition in Regulation 3(1)(c) has to be applied by reference to B's purposes for the entirety of the loan - given the difficulty in isolating a specific £5m portion. (We note that Regulation 5(3) applies an equivalent "commercial purposes" test to the creditor and that this would apply specifically to NL's £5m, by reference to NL's purposes for being party to that loan, in any event.)

Is this how HMRC see this condition as applying - i.e. you look at the time at which the original loan relationship (of which the new (assigned) "relevant security" is part) was entered into when applying this condition to the debtor?

Regulation 4, Condition B

This condition is the "minimum value" condition. There are two alternatives, both of which look to when the relevant security was entered into. Condition B reads as follows:

"Condition B is that—

(a) at the time the relevant security was entered into, it had a minimum value of £10 million; or
(b) where the relevant security had a lower value at the time it was entered into but it was comprised in a single placement with other relevant securities to the same debtor, the placement had a minimum value of £10 million."

These conditions relate to the private placement, and do not reference the perspective of either debtor or creditor. However, we assume these are intended to apply by reference to the debtor (i.e. in a similar way to Regulation 3(1)(c)), given the similarity of language). Applying that same approach, the £5m loan made by NL is the "relevant security". Therefore the first limb would not be met by that relevant security (even though met by the original loan).

The second limb is more apt to cover this situation (and would have applied had L and NL advanced their respective £15m and £5m at the same time in June 2019). We assume that similarly the second limb is intended to apply where NL acquires its interest in the loan as a result of an assignment: **is that correct?**

However, if this is the case, there is an ambiguity in the drafting, linked to the opening words of the second limb - which do not easily fit with an assignment.

Even though it can be said that NL's relevant security was entered into in June 2019 (by L as part of the original £20m loan), it was not then a separate relevant security. This is because at June 2019 there was a single placement consisting of one loan relationship only - as above, NL's relevant security did not exist in its own right. Therefore there is an issue because this limb requires value to be ascribed to that relevant security when it was entered into.

Applying this provision literally, it seems difficult to ascribe value to something that did not technically exist. (We note that as originally drafted, this regulation did not refer to the value of the relevant security at the time it was entered into: we understand this was added to provide clarity as to the different situations the two limbs referenced.)

However, if this provision can be read purposively, it seems that the subsequent division of a single loan into two or more relevant securities would be read back to June 2019 - if the "new" relevant security is regarded as entered into in June 2019, it must be deemed to have existed at that date - and as a result was

comprised in a single placement of over £10m (it seems clear that NL's £5m loan has to have been comprised within the single placement in June 2019).

Please can you confirm that, on the assumed fact-pattern above (with NL acquiring a £5m loan from L, where the original loan was more than £10m), NL can benefit from the QPP exemption assuming it provides a valid creditor certificate?

(If this were not the case, the effect would be that, where NL acquires £5m of an original £20m loan, NL cannot benefit from the QPP exemption, but if L subsequently sells a further £11m of the loan to NL2, NL2 could benefit from the QPP exemption on the basis that at the time the "new" relevant security is created, its value was over £10m. We assume this is not intended.)

Scenario 3: L transfers all or part of the loan to NL by novation

The previous two scenarios were relevant where L transfers an interest in the loan to NL by assignment.

Loan agreements may alternatively provide for a transfer by a lender of all or part of its loan by novation. Transfers by novation are envisaged in the LMA standard private placement documentation (see for example the LMA PEPP Facility Agreement at Clause 23.1(b) and Schedule 4 (Form of Transfer Certificate)). A novation would be appropriate where a lender has the obligation to make further advances for example.

The effect of a novation is (in broad terms) to create a new loan as between debtor and new lender as at the date of novation (see CFM31130. Strictly, therefore, if L were to transfer all or part of its loan to NL by novation, then as a legal matter the novated loan would be entered into by NL with B at the date of novation (and not when originally advanced by L).

In applying the Regulations to the novated loan, the question is whether NL's interest in the loan is regarded as a relevant security from the date of novation only (as a new loan relationship comes into existence at that point) or whether the same position applies as on an assignment.

We note here that, within the loan relationship rules, a novation would be a related transaction given s304(2) CTA 2009 (see CFM31120), and Chapter 4 (group transfers) applies to novations in the same way as it does to assignments (CFM34040) - see s338 CTA 2009). However these are not directly in point in relation to the Regulations.

Assuming the novation results in a new relevant security being created (which is the legal effect of a novation),the conditions referenced above would apply as at the date of novation (as that would be when the novated loan would be entered into as a legal matter).

On this basis, Regulation 3(1)(c) would apply as between B and NL on the basis that the NL's £5m loan was entered into by B in October 2019**(**this would be different to the position under an assignment when B's purposes in being party to the loan would be assessed at June 2019 only - so that tax advantage purpose in June would mean that no future creditor could then rely on the QPP exemption). **Do you agree?**

In relation to Regulation 4, if the novated loan (or part loan) is over £10m, the first limb of Regulation 4 would be met.

If however only £5m is transferred by novation, the issue is how the second limb would apply. At the date the new loan is entered into (October), it has a lower value than £10m. The issue is therefore whether the novated £5m loan "was comprised in a single placement with other relevant securities to the same debtor that had a minimum value of £10 million".

The single placement here is the original loan. The novated £5m is part of that loan - but only after it comes into existence. That being said, as the novation means that NL replaces L, the £5m loan is advanced on the

same terms as the original £20m loan - NL and L are both lenders under the same agreement, with NL having equivalent rights and obligations to those held by L. Further, the loan agreement would have contemplated (and set out the mechanics for) a transfer by novation.

The statutory language says "was" and thus appears to require a look back at when the single placement came into existence. Because the novated £5m relevant security did not exist at the time the single placement came into existence in June 2019 it is difficult, on a literal interpretation, to see how it could be "comprised" with that single placement.

However, assuming the look back allows regard to be had to the £5m part of the original loan comprised in the initial single placement that the novated loan in effect replaces, the second limb would be met.(We note that such an approach is arguably consistent with HMRC's treatment of further drawdowns (at SAIM 9340) - which do not exist (other than by way of contractual commitment) at the date the initial relevant security is advanced.)

Please can you confirm how Regulation 4 would apply in these circumstances?

We note that, assuming that Regulation 4 is capable of applying to a novation as described above, the effect is to treat novation differently to assignments (even though commercially they have the same effect). If this is not the intended policy outcome, it may be necessary to amend the Regulations (and even if it is an acceptable policy outcome, it may be helpful to amend the Regulations to clarify how Regulation 4 applies in any event).

If you would like to discuss any of the above, please contact me at SSquires@crefceurope.org.

Yours sincerely

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