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CREFC Europe and BPF comments on HM Revenue & Customs' Double Taxation Treaty Passport Scheme review

The Commercial Real Estate Finance Council (**CREFC**) Europe is a trade association promoting a diversified, sustainable and successful commercial real estate (**CRE**) debt market in Europe that can support the real economy without threatening financial stability. Our members include lenders and intermediaries who help connect capital seeking the risk and returns of CRE debt with property firms seeking finance.

The British Property Federation (BPF) represents the UK CRE sector. We promote the interests of those with a stake in the UK built environment, and our membership comprises a broad range of owners, managers and developers of real estate as well as those who support them. Their investments help drive the UK's economic success, provide essential infrastructure, and create great places where people can live, work and relax.

Introduction

We are grateful for the opportunity to comment on the HM Revenue & Customs (**HMRC**) Consultation Document on the Double Taxation Treaty Passport scheme review. This new exemption from withholding, introduced in the Finance Act 2015, offers a valuable opportunity to increase the role of private placements as a source of finance for critically important sectors of the UK economy.

We are very supportive of this initiative to both review the operation of the Double Taxation Treaty Passport Scheme (DTTP Scheme) and consider the possible expansion of the DTTP Scheme to non-corporate lenders and borrowers. In our view, any measures which reduce the administrative burden for both lenders and borrowers, and thus facilitate the functioning of the UK lending market (and in particular encourage the provision of finance to UK borrowers by new categories of lender) are a positive step.

Background

The efficient and productive functioning of business in the wider economy relies on investment into CRE. It provides accommodation for businesses that suits their needs and allows them the flexibility to adapt and relocate with changing economic conditions.

As a capital intensive and long-term business often involving very large, valuable and illiquid assets, CRE is dependent on the ready availability of debt finance to supplement and complement the equity invested by CRE owners. That is especially so outside the prime central London market to which so much international equity capital is drawn. The UK CRE industry has historically sourced debt finance mostly from the banking sector (including banks resident outside the United Kingdom that rely on the availability of treaty relief to receive gross payments of interest). During the last CRE boom the bulk of that finance was procured from a relatively small number of systemically important banking institutions.

When the CRE market went into sharp decline in 2008, many banks suffered significant losses or delays in recovering principal lent because borrowers were unable to sell or refinance their assets. That exacerbated the unavailability of new credit for the economy at large during what proved a particularly slow and protracted recovery from the crisis (just when it was most needed, and despite the fact that investments (equity or debt) made at that point in the cycle often perform very well).

In the period 2013-2015, CRE lending has recovered well, with strong supply both from the banks and from a range of new lenders (including insurance companies, pension funds and other institutional investors) and new vehicles for non-originating capital providers.

Many of these 'new' lenders are based outside the UK. Some of these new lenders originate debt directly; others acquire participations through the syndication market (or otherwise acquire existing loans). In both cases, given that the loan market works on a presumption of gross payment - lenders expect to receive interest free of withholding, and borrowers expect to pay the net interest only (i.e. without having to "gross up" for any shortfall resulting from withholding tax) - the ability of such new lenders to receive gross payment of interest is important to their being able to have a role in the CRE finance market. Therefore, their ability to lend is ultimately dependent on the relevant borrower having received a direction from HMRC under Regulation 2 of SI 1970/488.

To put this in context, the De Montfort University Commercial Property Lending Report 2015 (an annual survey of the UK commercial property market) identified that, of the over £53.7bn of loans originated in 2015, UK banks and building societies were responsible for 34% of new loans (down from 39% in 2014). Insurance companies were responsible for a further 16% of loans, with other non-bank lenders (including debt funds) representing 9% of such origination. This report noted that the approximate amount of outstanding debt secured by UK commercial property is at least £168bn.

We believe the current diversity in the UK CRE debt market is to be welcomed and should be supported. Supporting a diverse and resilient CRE debt market is especially important now that the UK's recent EU referendum has cast considerable additional uncertainty over financial markets still adjusting to continuing post-crisis tax and regulatory reform.

We consider that the (current) DTTP Scheme supports such diversity, given that, by simplifying some of the administration involved in the making of a claim for relief from withholding under an applicable double tax treaty, it removes some of the administrative and cash flow costs that UK companies and their non-UK lenders could otherwise bear. We therefore particularly welcome HMRC's willingness to consider expanding the scope of the DTTP Scheme, given that any expansion should facilitate the continued diversification of the UK CRE loan market.

Comments

- ***The DTTP Scheme should continue - and ideally be extended***

The DTTP Scheme meets its initial objective of providing an administrative simplification for corporate-to-corporate lending. HMRC should definitely continue to offer and operate the DTTP Scheme. A return to the certified claim procedure for all treaty lenders would, in our view, be damaging to the operation the CRE lending market.

But given how the CRE lending market (and indeed other loan markets) have evolved since 2010, **the scope of the DTTP Scheme should be broadened to include non-corporate borrowers:** this is particularly important for CRE, where borrowers can often be partnerships or unit trusts.

We appreciate that for non-corporate lenders issues as to confirming treaty status raise particular challenges given how the DTTP Scheme. However, such lenders are able to benefit from the self-certification regime set up under the new "qualifying private placement" exemption. **We therefore**

consider that, as a first step, HMRC should look to include in the DTTP Scheme those non-corporate lenders who can readily prove their treaty eligibility in the DTTP Scheme. Even if changes are limited at this stage, HMRC should commit to keeping this under review.

- ***Passports should be available for more than five years***

Passports are currently granted for five calendar years and are generally renewed if there are no material changes.

Therefore, once granted a lender can anticipate an effective ten year passport - but still has the administrative inconvenience of having to renew halfway through. While the typical duration of a CRE loan advanced by a UK bank is in the three to five year range, longer duration loans are becoming increasingly common in the present low interest rate environment, particularly from other sources of finance that may need the passport, and its renewal after five years.

HMRC has said in the DTTP Scheme Technical Q&A that "we may make a policy decision to extend it in the future but that depends entirely on how the Scheme works". **We consider that, with its experience of the DTTP Scheme to date, HMRC should now extend passports to a minimum of ten years.**

- ***The potential impact of BEPS Action 6 on Treaty Abuse***

As a result of the OECD's BEPS project, there is current uncertainty as to the future treaty position of certain types of lender (the "non-CIVs"). Given the increase in diversity of lenders, the non-CIV sector is increasingly playing an important role in the CRE finance market. It is important that uncertainty is minimised so that such lenders do not see their competitiveness inappropriately handicapped

Given the potential uncertainties for non-CIVs under the principal purpose test (which we understand the UK prefers), **we ask that HMRC ensures that the DTTP Scheme Technical Q&A include detailed and unambiguous guidance on its interpretation of the operation of the principal purpose test**. This is essential for lenders to be able to be confident that, when they use their passport, they are using it properly.

We are at your disposal should you have any questions about the points raised in this note.

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Appendix - The Questions

Question 1: Is the current DTTP scheme meeting its objective of providing an administrative simplification for corporate-to-corporate lending and should it be continued? The alternative would be to return to the "certified claim" approach for each loan.

Non-UK resident lenders very much welcome the administrative simplification that the DTTP Scheme provides to the treaty claims process - and in particular the way in which a DTTP Scheme passport provides certainty as to both treaty eligibility and the shorter timetable for the issue of a treaty direction (generally within 30 days of the DTTP2 being filed).

As we mention above, the CRE loan market works on an assumption of gross payment. As a result, loan documentation generally contains market-standard provisions designed to allocate the risk of withholding tax as between (different types of) lender and borrower. Where loans are cross-border, the treaty status of a potential lender is therefore of direct relevance when deciding to transact.

Any uncertainty as to whether withholding might apply to a payment - including as a result of uncertainty as to when a treaty direction may be made - impacts the allocation of risk between lender and borrower. Such uncertainty threatens the economics of the loan (through a lender receiving net funds or a borrower having an increased costs of funds as a result of a gross-up applying) and thus its viability. The DTTP Scheme assists loan counterparties by removing much of that uncertainty in practice.

We therefore believe that the DTTP Scheme is meetings its initial objective of providing an administrative simplification for corporate-to-corporate lending. Therefore, HMRC should continue to offer and operate the DTTP Scheme. A return to the certified claim procedure for all treaty lenders would, in our view, be damaging to the operation the CRE finance market.

That being said, the CRE finance market (and indeed other loan markets) have evolved since 2010, with one particular feature being a greater diversity of lenders. **We therefore welcome HMRC's willingness to consider expansion of the DTTP Scheme beyond corporate-to-corporate lending**.

In addition, we consider that this review provides a valuable opportunity to revisit the operation of the scheme, and consider whether any improvements could be made, enhancing its efficiency.

We have the following suggestions to improve the DTTP Scheme's efficiency further:

1. At the time the DTTP Scheme was introduced, HMRC said that it was unable to offer an automatic clearance in response to a correctly completed DTTP2 because of IT capability issues. Given the increased reliance on digitisation of tax compliance, is HMRC in a position to reconsider this (whether now or in the near future)? **Automatic issuance of a direction would be particularly helpful for those passported lenders that acquire interests in loans as part of secondary market dealings** (including as part of syndication) and so may acquire their participation just before an interest payment date.

2. Given that, under the DTTP Scheme, lenders provide certain undertakings to HMRC (unlike the position under the certified claims procedure where notification obligations fall on the borrower only), we would ask HMRC to consider allowing DTTP Scheme passported lenders to benefit from directions of more than five years on request.

   It is common for CRE loans advanced by UK banks to be for between three and five years, but longer-term loans are becoming more common, not least because of the persistently low interest rate environment and the growing role of other types of lender (many of whom will be reliant on DTTP Scheme passports). Accordingly, **the process would be more efficient for lenders if the**

direction could more generally be linked to the length of the loan, obviating the need for a renewal after five years.

The guidance included in HMRC Residency Double Taxation Guidance Note 8 (referred to in question 3 of the DTTP Scheme Technical Questions and Answers (**DTTP Scheme Technical Q&A**), but no longer of effect) stated:

> "*The reason that we require a fresh application is to give us all of the information we are likely to need to verify that the non-resident person continues to qualify for treaty benefits.*
>
> *As an exception to the normal rules, in these cases, the completed form does not need to be certified by the overseas tax authorities. Instead, the form should be sent direct to HMRC Residency together with a covering letter.* ***This covering letter should include an assurance that there has been no material changes to the terms of the contract for which approval of treaty benefits has already been given***."

We consider that the undertakings given by a passported lender as part of the terms and conditions of the DTTP Scheme provide HMRC with equivalent assurances, without the need for a further application.

3. As discussed in our response to question 3 below, **consider extending the initial term of a passport to say, 10 years** (the alternative period referred to the DTTP Scheme Technical Q&A).

4. For new lenders, particularly those that carry out their lending activity through special purpose vehicles (such as debt funds, pension funds and sovereign wealth entities), lending activity may start within a very short period after their establishment. For such lenders, i**t would be helpful if filing of a DTTP2 could be made in respect of any loan they advance whilst their application for a treaty passport is being considered**.

   Currently, the lender files its DTTP1, and when it receives a passport, it must then notify any borrowers, who are only then able to file their DTTP2 (loan agreements often place the withholding risk on the first interest payment date on the lender, and hence the lender may be out of pocket - subject to the ability to make a further (certified) claim to recover the amount of tax withheld and resultant timing cost - where the borrower does not file the DTTP2 promptly (as the DTTP Scheme Technical Q&A notes at question 16, some borrowers may be unfamiliar with the passport scheme and, once the loan has been advanced, such a borrower may be less incentivised to deal with administrative matters quickly. (Where a lender originates and has an existing passport, the completion and filing of a DTTP2 by the borrower can be included as a condition to the loan being advanced, and so the lender can better control the timing of the DTTP2's submission.)

5. Condition 1 of the DTTP Scheme Terms and Conditions says that passporting applies to UK corporate borrowers. We understand that this is not the case in practice, with HMRC accepting that DTTP Passports can be used on loans to non-UK companies and to UK permanent establishments of non-UK companies. It would be helpful if this Condition could be updated to reflect HMRC practice here (which we firmly support).[1]

Question 2: Do the current DTTP arrangements create any barriers to the making of debt-based investments in the UK?

The current DTTP arrangements facilitate corporate-to-corporate lending within the UK. For other lenders and borrowers, the certified claims process remains available as before and so (in absolute

[1] It would also be helpful if links to the DTTP Scheme Terms and Conditions and Technical Q&A could be put on the treaty passport webpage (https://www.gov.uk/guidance/double-taxation-treaty-passport-scheme), No such link currently seems to exist.

terms) a non-passported treaty lender has equivalent treatment in terms of relief from withholding - there is no distinction.

However, the timing and administrative benefits conferred by the DTTP Scheme advantage those lenders that have a passport (as compared to those that need to make "full" treaty claims - particularly given the benefits to borrowers of transacting with a passported lender). Therefore **we would welcome any extension to the scheme that allows non-corporate lenders and borrowers to benefit from the scheme.**

Question 3: Is the passport renewal process operating appropriately? If not, how should it work?

The terms and conditions of the DTTP Scheme state that a passport is valid for five calendar years (subject of course to HMRC's ability to withdraw a passport in the event of misuse). Given that the DTTP Scheme was introduced in September 2010, many lenders have not yet experienced the renewal process.

The renewal process, as summarised in the DTTP guidance, states that a passport will be renewed provided that there are no material changes.

However, we note that under the DTTP Scheme Terms and Conditions, a lender undertakes to inform HMRC of any "material changes" to its form or circumstances (condition 16). Therefore, if there has been no such notification, renewal would appear to be automatic (assuming that the paperwork is submitted timeously) - which raises a question as to whether it is appropriate and proportionate to require passports to be renewed after five years.

The DTTP Technical Q&A states that HMRC "decided on five years initially" (question 2) and notes that "we may make a policy decision to extend it in the future but that depends entirely on how the Scheme works".

We therefore ask HMRC, as part of this review, to consider extending the time period for which a passport is granted, taking into account their experience to date of the scheme.

In terms of ensuring that the administrative simplicity of the current scheme is preserved, this would suggest introducing a new "fixed" passport period (which could be from seven years to ten years). However, it would be helpful if the scheme also introduced flexibility for a longer-term or perpetual passport on request.

For example, many debt funds are established with a fund life of between eight and ten years (which is often expressed as an initial eight year life, with an ability to extend for a further two years). For such funds, it would be very helpful to have a passport issued at inception of the fund that lasts throughout its life. In many cases, this should be achieved if passports were issued for ten years initially (the alternative period referred to in the question in the Technical Q&A). However, it would be helpful if such a (limited life) fund could apply for a passport that is in effect "perpetual" - i.e. it lasts until the fund "end" date.

We are aware of anecdotal evidence that there are some cases where lenders have apparently received a "perpetual passport". It would be helpful to understand the circumstances that led to HMRC being willing to grant passports for more than five years to lenders (assuming this has indeed happened).

Assuming that HMRC has indeed been willing, on application, to grant passports for more than five years, we consider that this practice should be formalised (providing both consistency and clarity to applicants) with the DTTP Scheme guidance setting out clearly the factors that HMRC would take into account in granting such a (longer) passport. This would allow any lender potentially eligible for and interested in a longer-term passport to provide relevant information to HMRC in support of its application.

We consider that the scheme, as it currently operates, should provide sufficient safeguards against the risk of misuse of a long-life passport.

- First, the passport does not itself confer a right to gross payment - the lender still has to apply for a treaty direction, which itself is usually granted for five years (although the DTTP Scheme Technical Q&A suggests that there may be flexibility for a direction to be granted for a longer period on a case by case basis).

- Secondly, under the DTTP Scheme Terms and Conditions, a lender undertakes (i) to use its passport only where treaty conditions are met (see also question 13 of the DTTP Scheme Technical Q&A) and (ii) to inform HMRC of any material changes in its status.

- Finally, HMRC reserves the discretion to deny the benefit of the passport scheme to particular lenders, loans and/or borrowers - and in addition could similarly retain discretion over whether to grant a perpetual passport.

If, at this stage, HMRC is not comfortable with allowing "perpetual passports" to certain lenders, then we would ask that the passport initial period be extended from its current five years to ten years (i.e. the higher end of the range mentioned above).

Question 4: Do the sanctions for misuse of the scheme need to be changed and/or strengthened?

We consider that the range of the sanctions available to HMRC if it identifies breach of the terms and conditions is appropriate. In particular they allow HMRC to marry the severity of the sanction with the gravity of the breach.

However, we consider it would be helpful if the guidance could provide some examples of when HMRC would look to use the more serious sanctions (suspension or removal of status) based on its experience of the usage of the DTTP Scheme to date. For example, it would be helpful if the guidance could confirm that an error by the borrower in its passport notification would not trigger a sanction against the lender.

Plus, under the DTTP Scheme, a lender undertakes to use its passport only where any treaty conditions are met - including beneficial ownership and (following implementation of BEPS Action 6 through entry into of the Multilateral Instrument) the principal purpose test and/or any limitation of benefits provision. An element of judgement will be involved in relation to these conditions - and it is of course possible that lender and tax authority take a different view. It would be helpful for there to be assurance that where a lender reasonably considers that such conditions are met (taking account of any available published guidance), HMRC would not generally look to invoke these more serious sanctions.

Question 5: Is the current scope of the scheme, which mainly covers corporate to corporate lending, adequate? If expansion is advantageous, what entities should and should not be admitted to the scheme and why?

5.1 ***General***

The DDTP Scheme offers an administrative simplification of the treaty claims process relating to relief from UK withholding tax on interest. Given that the DTTP Scheme offered a change in (then) administrative practice, it is understandable that, when first introduced, it was only made available to corporate-to-corporate lending - the "simplest case" as it were.

However, the DTTP Scheme has now been in operation for a number of years, giving HMRC the opportunity to monitor compliance with scheme conditions by the 3,000 or so lenders who have obtained passports. As a result, we consider that it would be advantageous to look to extend the scope of the scheme, particularly in relation to the types of borrower entity that can pay gross to passported lenders (see "Types of eligible borrower" below).

We also consider that, given the types of new lender coming into the CRE finance market, it would also be helpful to consider expanding the scheme to include non-corporate lenders.

However, we acknowledge that treaty eligibility of non-corporate entities may not be straightforward (as is evidenced, for example, by the recent OECD consultations under the BEPS 6 Action). This may mean that, for HMRC to be comfortable in any such expansion to allow non-corporate lenders to obtain passports, additional conditions may need to be satisfied, which may run counter to the administrative simplicity the scheme currently possesses.

We therefore appreciate that any extension to the DTTP Scheme to non-corporate lenders may initially need to be limited to those non-corporate lenders whose ongoing compliance can be "managed" relatively simply.

However, assuming limited change is made to the type of lenders that can obtain passports, we ask that HMRC keep this under review in light of general developments (both in relation to markets and international tax), including potentially committing to revisit this in 2020.

5.2 ***Types of eligible borrower***

Withholding is imposed for and on account of income tax, and is (in broad terms) a deduction of tax at source in respect of income due to the creditor.

The obligation to deduct an amount representing income tax from payments of yearly interest is imposed by section 874 Income Tax Act 2007 (**ITA**) .

Whether withholding tax is applicable is dependent on the source of that interest for tax purposes.

The factors that determine whether a payment has a UK source or not include factors relevant to the debtor (including its residence), but can also include other matters relating to the nature of the loan and the source of funds used to meet interest payments. A person other than a company may pay UK source interest - hence, section 874 ITA refers to payments by partnerships (of which a company is a member) and to payments by "any person" making payment to another person whose usual place of abode is outside the UK as well as applying to payments by companies.

Where a lender is resident outside the UK, the ability to claim relief from withholding under a tax treaty is generally dependent on two factors: first, its own eligibility for treaty relief (connected to both its residence for treaty purposes and its beneficial ownership of the interest) and secondly, the arms' length nature of the loan (as a result of the "special relationship" provision). In the context of the syndicated loan market, it is the first factor (the status of the lender) that will generally determine eligibility for treaty relief in practice.

This is recognised by the way the DTTP Scheme has been set up: a lender provides proof of tax residency and undertakes (in Form DTTP1) that it will not use the DTTP Scheme if the other treaty conditions are not met. The borrower form - Form DTTP2 - contains no such undertakings.

We therefore consider that the DTTP Scheme should be extended to apply to non-corporate borrowers who pay UK source interest. We agree with the comment made by the Office of Tax Simplification in its final report on Partnerships (as quoted in paragraph 2.6 of the Consultation

Document) - but, in the context of CRE, the same point also applies to other forms of non-corporate borrower.

In the CRE market, property owners include corporates, partnerships and unit trusts. Partnerships and unit trusts are commonly used by (equity) investors in CRE (including pension funds and sovereign wealth funds) to hold UK property given their (income) tax transparency. Given that CRE finance is often on a non-recourse basis, loans will often be made directly to such entities - with the lender being granted security over the relevant property asset(s).

We can see no reason why a lender should be prevented from using its passport in such circumstances - i.e. just because the borrower has chosen a particular structure for holding its investment for its own commercial reasons.

Borrower entities to which the scheme should be extended therefore include:

(a) English limited partnerships;

(b) limited partnerships established in other jurisdictions, with a similar legal framework to English limited partnerships;

(c) limited liability partnerships (**LLPs**); and

(d) unit trust schemes.

We note that, when setting up the DTTP Scheme, HMRC sought to include entities that possessed full corporate personality characteristics and so were accountable for their actions. In that context, management responsibilities would rest, in the case of a limited partnership, with its general partner; in the case of an LLP, with its members; and in the case of a unit trust, with its trustees – meaning that there is always a single, specific entity that would have responsibility for the required administration.

In addition, given that, as HMRC state in the DTTP Scheme Technical Q&A: “The possession and use of a treaty passport involves a significant departure from the traditional certified claim procedure with its checks and verification procedures”, a further condition to eligibility of any such entities could be that none of its members (whether partners or unitholders) are individuals.

This would in any event reflect the existing distinction within the statutory rules relating to withholding between individuals and other persons. (We note that, as investors in CRE include pension funds and sovereign wealth funds, the scheme should not be restricted to partnerships and/or unit trusts with exclusively corporate members. Hence the suggestion that ability to benefit from the scheme should be by reference to the exclusion of a particular category (individuals).)

Plus, HMRC would have further protection in relation to the risk of misuse of the scheme given its discretion to refuse to apply the scheme to a particular borrower or to a particular loan.

5.3 ***Types of eligible lender***

Given that the purpose of the DTTP Scheme is to simplify the UK treaty claims procedure as it applies to treaty eligible third party lenders that lend to UK borrowers, **we consider that the starting point should be that any lender that qualifies under a treaty should be able to claim a passport**.

The Consultation Document refers to different types of lender that could be added to the scope of the DTTP Scheme. Each raise different issues relating to treaty eligibility (see our comments on question 9 and 10 in relation to sovereign investors and pension funds).

In relation to CRE finance, many debt funds are established as partnerships, given the tax transparency a partnership structure provides to its investors (the structuring seeks to replicate, so far as possible, the tax position that would apply had the investors made the fund's investments themselves). This means that treaty status is dependent on the status of the investors, not the fund.

In general, debt funds will often establish special purpose companies to make their investments. This in part reflects how the market works: borrowers typically expect to deal with lenders in corporate form (and this is reflected in market-standard loan documents). Using a company means that investors can be insulated from certain legal risks by virtue of the resulting "corporate veil". Plus, certain jurisdictions may have specific regulatory requirements which need to be met for an entity to be allowed to lend to borrowers into the jurisdiction - which can be more easily complied with by a company.

However, an extension to the DTTP Scheme to allow (some, if not all) partnerships to benefit from it would, in our view, be helpful for the UK market. It would facilitate direct investment by the fund into the UK market, and could also be useful as (in effect) providing an "umbrella" passport which could then be referenced in (and thus facilitate) passport applications by any subsidiaries set up by the fund to make specific UK investments.

In this context, we note the recent introduction of the qualifying private placement exemption. This also offers (in effect) a simplified treaty process - in this case, cutting out the need for any treaty clearance by instead relying on self-certification.

Under that exemption, a (general partner on behalf of a) partnership lender is allowed to self-certify their status as treaty eligible by giving a creditor certificate. HMRC has no role in pre-clearing that certification (although it has a right to challenge under the cancellation procedure following enquiries).

Although we appreciate that this exemption is intended to encourage the growth of a private placement market in the UK, the syndication market plays an important role in ensuring debt finance is available to UK business (as well as providing access to CRE debt investments for investment capital with no origination platform). Therefore, **it would seem desirable (from a policy perspective) that a type of lender who is allowed to self-certify within the qualifying private placement rules is similarly permitted to apply for approval from HMRC as a passported lender.**

Finally, the DTTP Scheme Technical Q&A refers (at question 11) to the treatment of securitisations, with specific reference to the use of the passport scheme for securitisations over loans to individuals (presumably residential mortgage-backed securities (or RMBS) structure0.

It would be helpful if the guidance could specifically confirm the right of a securitisation vehicle in a commercial mortgage-backed securities (or CMBS) structure to use the passport scheme in the same way as a "normal" corporate lender (given that this would be a corporate-to-corporate transaction).

Question 6: What potential benefits and/or difficulties may arise from admitting UK partnerships to the DTTP scheme as borrowers?

See answer to question 5 above (Types of eligible borrower).

The Consultation Document notes that partnership borrowers are excluded from the qualifying private placement exemption.

We understand that this exclusion followed on from the approach taken in the DTTP Scheme - and in particular that, as part of the stakeholder discussions, HMRC noted that the inclusion of partnership borrowers was something that could be considered after the exemption had been in operation for a few years, should there be a demand for the rules to be so extended.

Question 7: What potential benefits and / or difficulties may arise from issuing passports to partners in overseas partnerships if they are admitted to the DTTP scheme as lenders?

Debt funds are generally established as partnerships.

A principal benefit of admitting such partnerships to the DTTP Scheme would be to facilitate direct investment (and thus provision of finance) by the fund into the UK. It would also simplify the treaty process for both HMRC and the fund as, once eligibility has been established, there would be a single point of contact for treaty applications (the fund itself, rather than a series of treaty applications by different investors).

The difficulties of admitting funds link to HMRC being comfortable as to ongoing treaty eligibility given that treaty status of the fund will depend on the residence of the investors.

We note that one of the reasons HMRC initially focused on corporate lenders was so that the application was made by an entity that was "wholly responsible and accountable for its actions". As debt funds involve the pooling of funds by (passive) investors, the partnerships are generally structured as limited partnerships (or equivalent) with a general partner responsible for administration and management. We consider that, as the general partner has power to bind the fund, the general partner would have the required responsibility and accountability in this context - so we do not see the nature of a limited partnership as raising any difficulties in terms of this aspect of the scheme.

Question 8: If partnerships were admitted to the DTTP scheme, how would HMRC police this and receive sufficient information on the parties involved to prevent abuse, whilst keeping the compliance burden low on both sides? For example, should partners' passports have a shorter duration of one or two years and be contingent on all of the partners being either companies or individuals resident in the same jurisdiction?

As stated in our comments on questions 5 and 7, we acknowledge that determining the treaty status of partnerships is less straightforward than for other entities. We acknowledge that initially any extension of the DTTP Scheme to partnerships may need to be limited, to allow HMRC to test compliance.

A possible interim extension could be as follows:

1. Only funds established as limited partnerships (or equivalent) can apply for passports.

2. An eligible fund should have no more than a specified number of investors (to facilitate monitoring). In this context, many debt funds have no more than ten investors. Perhaps a suitable limit would be twenty partners (reflecting the Limited Partnership Act 1907 restriction)?

3. The investors in the fund should themselves be eligible for a treaty passport that, if granted, would allow them to receive interest gross (i.e. corporates or, if the scheme is extended, sovereign investors or pension funds).

   To reflect commercial realities, investors should be able to be from more than one jurisdiction. HMRC should be provided with the same information as to the partners that it would request if a certified claim was being made: but the passport would be issued to the partnership (on behalf of the partners), not to the individual partners themselves.

4. The general partner will be responsible for administration of the passport, and provide the relevant undertakings to HMRC on behalf of the fund in terms of (a) use of passport and (b) the obligation to notify HMRC of material changes.

Material changes would include a “new” investor - and so the passport would remain valid as long as the investors remain the same (note that an investor leaving would not invalidate the passport). In this way, the process is the same as for a corporate investor.

5. If a new investor joins, the general partner would need to submit a new application. (For many debt funds, after the initial investor phase, the investor pool is relatively static throughout the fund’s life.)

6. The passport life should be five years (the current period - even if that period is extended for corporate lenders). For this initial period, the passport could be limited in application to loans to corporate borrowers as a further protection.

7. HMRC’s safeguards derive from (a) the information it receives as part of the application; (b) the undertakings it receives from the general partner; (c) its general discretion to refuse to issue or apply a passport and (d) its right to review how a passport holder uses its passport at any time.

We would recommend that HMRC commit to review the application of the scheme to partnerships after a period of, say, three years. The purpose of such review would be to look at broadening the scheme further (assuming no issues have been identified with its more limited operation).

Question 9: Are there any obstacles to prevent sovereign investors and overseas pension funds being admitted to the DTTP scheme, such as issues of liability to tax and entity characterisation? Admittance to the DTTP scheme would also require publication of their names in the public register of passported lenders.

In terms of a sovereign investor, treaty status will be dependent on how it is constituted and the terms of the applicable treaty.

The same applies to pension funds. If such a person is a qualifying treaty resident, they should be entitled to apply for a passport in the same way that a corporate lender is currently able to do.

The discretion that HMRC has retained for itself to refuse to accept an application for a passport means that HMRC can ensure that it is only treaty eligible entities that are given a passport.

In addition, the recently enacted qualifying private placement exemption from withholding made specific provision for sovereign investors. Under regulation 5 of the Qualifying Private Placement Regulations 2015/2002, treaty “resident” is given a broader meaning to include a person that is the State or part of a State who is not otherwise a resident for treaty purposes. The qualifying private placement regime relies on self-certification by the creditor as to its treaty eligibility - and HMRC is not involved in confirming that status (although it can subsequently challenge - and cancel - the certificate given by the creditor under regulation 7).

We consider that a similar rule should apply concerning the eligibility of an investor under the DTTP Scheme. We note however that legislative provision was needed for the qualifying private placement regime (and that HMRC state that the consultation does not intend to initiate legislative change): we are therefore unclear if HMRC’s powers would allow it to confer equivalent status on sovereign investors under the DTTP Scheme: if they do, we consider such a change should be made.

To the extent that sovereigns or overseas pension funds might have concerns around, for example, the publication of their names in the public register of passported lenders, it would presumably be open to them not to use the DTTP Scheme.

In terms of the implications for partnerships set up by sovereign investors, see answers to questions 7 and 8.

Question 10: Other than those detailed above, what investment structures are typically used by sovereign investors and pension funds, and are these suited to the mechanics of the DTTP scheme?

Sovereign investors and pension funds may decide to invest through an intermediate special purpose company: either owned directly or by a partnership of which sovereign investors/pension funds are members.

Generally, as the lending vehicle is a corporate, it should be able to apply for a passport in its own name, and so the DTTP Scheme would operate normally.

However, we are concerned as to the potential implications for lenders of the OECD BEPS Action 6 work stream, and in particular the inclusion in treaties of either or both of a limitation of benefits provision or a principal purpose test following execution (and ratification) of the Multilateral Instrument in early 2017.

The recent Discussion Draft issued by the OECD concerning treaty entitlement of non-CIVs highlighted a number of issues linked to this type of investment structure and it is currently unclear whether (and to what extent) the OECD Commentary on its Model Convention will provide clear and useful guidance on when such a special purpose company will be entitled to treaty benefits.

In form DTTP1, the lender undertakes that the passport will only be used where the conditions for relief set out in the relevant treaty are satisfied. There is therefore a potential risk that, having obtained a passport, a lender that is a special purpose company not have sufficient certainty as to whether treaty conditions are met - and so the passport could effectively be redundant in practice.

We therefore consider that, whether or not the passport scheme is extended to include new lenders, HMRC ensure that the DTTP Scheme Technical Q&A include detailed and unambiguous guidance relating to its interpretation of BEPS Action 6, either directly or through a link to the International Manual, so that lenders can, in appropriate cases, have assurance that they can use their passport for a particular loan.

We note that similar issues arise for debt funds, who generally make investments using a special purpose company (sometimes using a separate company per loan). Again, i**t is important that HMRC ensure that there is detailed and unambiguous guidance relating to its interpretation of BEPS Action 6 so such lenders can be certain as to their position under the passport scheme. Absent clarity, we anticipate that some lenders may revert to the certified claim method for treaty relief in order to obtain the necessary comfort as to treaty eligibility, defeating the purpose of the DTTP Scheme.**