Quoted Eurobonds - Will The UK Stay Open For Business?

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Remaining competitive from a tax perspective is a top priority for the UK but the Tax Authorities are also seeking to increase tax revenues where possible.

The voice of business has been loud and clear in recent years with regard to the tax treatment of financing through Quoted Eurobonds. However, as pressure builds in the media, Tax Authorities (HMRC) may opt to introduce draconian tax legislation, which would have a counterproductive effect and depress fund raising and economic growth.

What is a Eurobond?

UK Withholding Tax On Interest

In general, UK withholding tax becomes payable at the rate of 20% when a UK tax resident company pays interest on a loan to an overseas lender. Ordinarily, the UK borrower will not be disadvantaged because it can still benefit from a potential tax deduction for the whole of the interest. However, the lender may suffer a disadvantage: either a cashflow disadvantage because of time taken to recover the tax withheld, or an absolute cost if it is unable to recover the tax at all.

This withholding tax may not apply in certain cases, such as where the interest is payable to a corporate lender that is tax resident in an EU member state (if the conditions of the EU Interest and Royalties Directive are met), or tax resident in another country which has a tax treaty with the UK that reduces the rate of withholding tax to zero. However, in many cases no treaty applies, such as where the lender is in a tax haven. Even where a tax treaty does apply, various administrative requirements must be complied with, which takes time and money.

The Quoted Eurobond Exemption

In 1984 the Government introduced the “Quoted Eurobond Exemption”. Where this exemption applies, no UK withholding tax is payable when a UK tax resident company makes an payment of interest.

In order to benefit from the Quoted Eurobond Exemption, the debt must be a Quoted Eurobond at the point when interest is paid. A Quoted Eurobond means any security (generally loan notes, but not necessarily) that:

- is issued by a company,
- is listed on a recognised stock exchange, and
- carries a right to interest.

A recognised stock exchange is a stock exchange designated as such by the Board of HM Revenue & Customs.

Key Issues

In 2012, HMRC issued consultative proposals to terminate the withholding tax ("WHT") exemption1from cross border interest payments leaving the UK on Quoted Eurobonds (where such bonds are held between companies in the same group).

There were adverse responses from the business community, which rapidly convinced HMRC to cancel the proposals. This was a similar occurrence to an earlier proposal to unilaterally withdraw zero WHT on interest payments under Double Tax treaties. It was clear the changes would not actually increase Tax Revenue, but rather make it more difficult and expensive to raise funds, and make the UK less competitive than other jurisdictions in the urgent need to retain and develop Global Fund Raising.

There is a current concern that this specific topic is raised again, in the demagogue manner which agitates prejudice with crude misrepresentation. Offshore stock exchanges are portrayed by certain mediums as artificial, when in reality they are selected instead for speed, simplicity and low costs. Other major stock exchanges traditionally used are not mentioned because it is only extreme examples that generate headlines. Extremes such as this can also provoke poorly construed legislation.

Common Commercial Structures

Quoted Eurobonds are dealt with swiftly in electronic clearing and were always designed to operate free of tax throughout the European Union. There are numerous legitimate examples we have met, where a Quoted Eurobond is held by a group associate, typically when external funding is raised outside the UK, by Parent or SPV:

- A Luxembourg finance vehicle raising external funds and passing these on with matching terms to European associates;
- Long-term funding of UK Private Finance Investment Infrastructure investments, existing (e.g. Bridges, Hospitals) and future (e.g. Energy);
- Private Equity routing of Non-UK Funds Investments;
- Non-UK Parent passing on external funds raised to its International Subsidiaries, including the UK;
- Other EU countries outside the UK also exempting WHT on Interest Payments, respecting a Quoted Eurobond held by a Group Associate.

The UK has multiple (specific and general) legislative tools to police cross-border interest payments leaving the UK and ensure that artificial connected party arrangements do not damage the UK tax take. Indeed a key advantage of the UK is the facility to engage in formal and informal dialogue to ensure compliance with HMRC views, for certainty in future plans is the key objective of long-term funding and pricing. The main complaint of investors in more volatile countries is the uncertainty in the rule of law and its partial application. It deters foreign direct investment to the UK when international investors begin to judge the UK tax base in a similar light.

Moving Forward

The issue remains under review by HMRC and pressure continues to build which may lead to the introduction of restrictive measures in a softened format to the last attempt in 2012. This forces fund providers to assess country specific risks, as well as specific commercial risks. It is common for transactions to build in exit and "gross-up" clause protections, and consider other countries for investment, and may hurt the UK's perception as a centre for investment.

It is a credit to the consultation process that previous proposals have been withdrawn after mature reflection and it is an important time for businesses to respond to consultations and policy forums – A&M is involved in discussions on this matter and can include any submissions that readers would like to raise. Without the consultation process, this would otherwise be a classic example of harsh tax plucking, driving away the economic Golden Goose on which it relies.

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1 Otherwise a 20% charge would apply

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