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TAX ADVISORY

Note on Proposed Changes to UK Taxation of Securitisation Vehicles

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Securitisation is a widely used method of raising debt finance on capital markets through the issue of asset-backed securities. Typically, income-producing assets are used as collateral backing for the issue of securities by a special purpose vehicle (the note-issuing SPV). The note-issuing SPV will normally only retain a small cash profit over the duration of the transaction. In the government consultation of 23 March 2021, the government highlighted that it is looking at ways to ensure that the taxation system of the UK is accurately aligned with the operation of capital markets in the UK.

The government acknowledges the important role securitisations play in funding, capital liquidity and risk management. Recognising the limited role of the note-issuing SPV, the government's corporation tax policy on note-issuing SPVs is that tax should only be paid on the retained profits (provided certain conditions are met).

Brief Background on Corporation Tax Rules for Securitisation

Before 1 January 2005, accounting profits largely reflected the cash profit, and corporation tax would consequently be chargeable only on that accounting profit under usual corporation tax principles.

After 1 January 2005, there were changes made to the applicable accounting standards that affected the predictability of the accounting profits of a note-issuing SPV. As a result, special corporation tax rules were introduced in order to make the tax charge year on year more regular to enable the securitisation market to continue to function effectively.

From 1 January 2007, a special tax regime was introduced for 'securitisation companies'. Under this regime a company is a securitisation company if it meets the following conditions:

1. it is a party as a debtor to a capital market investment in respect of which securities are issued and which is part of a 'capital market arrangement';
2. it meets the conditions to be one of five types of securitisation company specified by the Regulations (SI 2006/3296) (i.e., a note-issuing company, an asset-holding company, an intermediate borrowing company, a warehouse company or a commercial paper funded company); and
3. it has provision for a 'retained profit' (i.e., an amount required to be retained as profits).

In order to be considered a note-issuing company, the following conditions must be met (highlighted sections are particularly relevant for the consultation):

1. ***the securities representing the capital market investments must be issued wholly or mainly (which is interpreted by HM Revenue and Customs (HMRC) as more than 50 percent) to independent persons;***
2. the total value of the capital market investments made per capital market arrangement, and therefore notes issued representing those capital investments, ***must be at least £10m***; and
3. the company's only business, apart from being a debtor to a capital market arrangement and from any incidental activities, must be acquiring, holding or managing ***financial assets*** forming the whole or part of the security for the capital market arrangement (or equivalent rules in relation to guarantor arrangements).

Conditions (2) and (3) refer to a 'capital market arrangement'. Broadly, a capital market arrangement typically involves the issue of securities to a third party investor which are rated by an internationally recognised agency and traded on a recognised stock exchange.

The government is trying to ensure that the UK retains its competitiveness as a global financial centre, and the government believes one way to do that is to expand the situations in which securitisations are taxed only on retained profits (i.e., by relaxing the conditions listed above). To this end, the government is seeking opinions on the topics listed below in its consultation document.

Retained Securitisations

Retained securitisations are those where more than 50 percent of securities issued by the note-issuing company are not issued to third parties but are acquired or 'retained' by the originator. To fall within the current definition of 'securitisation company', the third party to whom the securities are issued must not be a connected person within the meaning given in s1122 CTA 2010 (e.g., a company is connected to another if both companies are controlled by the same person). There is some guidance in the HMRC manual on whether a person would be regarded as independent (i.e., not connected) in the context of retained securitisations. The independent person test applies to all securities that are issued as part of a single capital market arrangement, rather than to each individual bond or class of bonds. The test will not be failed where the issue is made via a connected person but ultimately ends up with an independent person (provided the connected intermediary had no right to retain the notes). Nevertheless, the government is considering making the legislation on this topic clearer so that there is less confusion as to who should be considered a connected person. The government is also seeking opinions on the importance of retained securitisations in general and is calling for responses on whether the legislation should be changed to bring retained securitisations within the regime.

Financial Assets

Regulation 9A of the Taxation of Securitisation Companies Regulations 2006 (SI 2006/3296) gives the expression 'financial asset' and this has the same meaning it has for generally accepted accounting practice but—

a) includes derivative contracts as defined for the purposes of Schedule 26 to the Finance Act 2002 (see paragraph 2 (1) of that Schedule (2)) whether otherwise constituting an asset or a liability; and
b) does not include shares (other than shares in a securitisation company which is party to the capital market arrangement).

The government is considering whether this definition should be expanded and whether certain additional shares should be included within the definition (e.g., shares resulting from a restructuring or bailout of an existing securitisation). However, it is aware that if the definition of financial assets is extended this may impact on other parts of tax legislation (e.g., the corporate interest restriction).

Minimum Note Issuance Threshold

One of the conditions of being a note-issuing company is that the value of the capital market investments made under the capital market arrangement — currently securities representing those investments — should be at least £10m. The securitisation industry has expressed concern that the £10m threshold is restrictive and excludes, for example, charities. The government is considering this threshold but is worried that a reduction might mean that other arrangements would be inadvertently caught by the regime. Therefore, the government is considering whether there should be more flexible finance options for different sectors (e.g., a reduced threshold for charities only).

Stamp Duty Loan Capital Exemption

The transfer of loan capital is generally exempt from stamp duty under the loan capital exemption (unless the loan capital is in some way related to equity) under s79 Finance Act 1986:

"Stamp duty under Schedule 15 to the Finance Act 1999 (bearer instruments) shall not be chargeable on the issue of an instrument which relates to loan capital or on the transfer of the loan capital constituted by, or transferable by means of, such an instrument."

The consultation highlights areas of this exemption that often cause confusion and the government is therefore seeking opinions on these topics:

1. there is uncertainty as to whether notes issued by the note-issuing company in securitisation arrangements can be transferred without a stamp duty liability arising. The government acknowledges that the workarounds to deal with this uncertainty are often complicated and increase the costs of the securitisation process;
2. there are potential stamp duty liability problems when pools of loan assets are transferred as part of securitisation arrangements, particularly if many small loans are being securitised; and
3. uncertainty as to whether notes issued by insurance SPVs are eligible for the stamp duty loan capital exemption.

The deadline for responses to this consultation is 3 June 2021.

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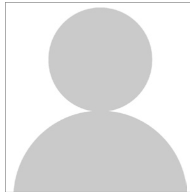

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