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Simplifying Treaty Relief from Withholding Tax on Interest Paid Overseas
Response by the Chartered Institute of Taxation

1. Introduction

1.1. The Chartered Institute of Taxation (CIOT) is the leading professional body in the UK for advisers dealing with all aspects of taxation. We are a charity and our primary purpose is to promote education in taxation with a key aim of achieving a more efficient and less complex tax system for all. We draw on the experience of our 20,000 members, and extensive volunteer network, in providing our response.

1.2. The consultation on simplifying treaty relief from withholding tax on interest paid overseas is welcome. The CIOT has asked HMRC to look at its processes for treaty clearance for payments of interest over many years, suggesting a self-assessment and online process, so we are pleased that the government is now considering this.

1.3. Due to the relatively short consultation period, which is running over the summer, we have limited our comments to more high-level points around underlying principles. Our aim is to ensure, so far as possible, that any new process will be practicable, achieve HMRC's policy aims and meet the CIOT's objectives for the tax system. Our stated objectives are for a tax system that includes a fair balance between the powers of tax collectors and the rights of taxpayers (both represented and unrepresented) and a responsive and competent tax administration, with a minimum of bureaucracy. There also needs to be greater simplicity and clarity, so people can understand how much tax they should be paying and why and certainty, so businesses and individuals can plan with confidence.

1.4. Overall, we are supportive of a self-assessment system as a way of reducing the administrative burden on taxpayers and HMRC. A more streamlined or self-certification system would be attractive to taxpayers, and we recognise that HMRC will need to retain sufficient visibility over cross-border financing arrangements to ensure that treaty benefits are only claimed where appropriate. While a new regime along self-assessment lines will present some challenges, these are largely the same challenges as exist with the current system but in a different form, because the underlying law as to when withholding is required will not change. A self-assessment system would, to some extent put additional risk on the borrower. But the need to ensure that treaty relief is available exists in the current system, and the due diligence needs to be done to apply for the HMRC clearance to pay interest gross or at a reduced treaty rate.

1.5. It is disappointing that the issues arising from HMRC's ongoing pause of its concessionary treatment[1] are outside of the scope of this consultation. The suspension of this concessionary treatment has increased the practical importance of obtaining treaty clearance and, for many businesses, has added both cost and administrative complexity to cross-border financing.

1.6. A more efficient UK withholding tax regime which offers certainty of treatment for UK borrowers and lenders to the UK, while also reducing administrative burdens for businesses and HMRC will help the UK's debt markets compete better with global debt markets that do not have a purely clearance-based system.

2. The current processes for withholding tax on interest

2.1. Question 1 – To what extent do the current processes for obtaining treaty relief on interest create delays, costs, or administrative burdens? Which specific aspects cause the most difficulty? Please provide examples or evidence where possible. Question 2 – How well does the current process for obtaining directions in advance of payments of interest allow easy and certain access to treaty relief?

2.2. We welcome this opportunity to comment on the challenges within the current processes for paying interest gross and without withholding tax where treaty relief is available. These include some comments on the concessionary treatment, which, while out of scope, as noted in the consultation document provide context for the consideration of the current system. We would encourage HMRC to consider these and address the issues where possible even while consulting on and considering more substantive changes to the UK rules.

2.3. In addition, a new system should be designed to ensure that these challenges and issues are removed or minimised so far as possible.

2.4. ***Acknowledgement delays*****:** The HMRC acknowledgement of receipt of the form to tell HMRC about a 'passported' loan under the Double Tax Treaty Passport (DTTP) scheme (form DTTP2) is no longer issued automatically and can take several business days—in some instances, up to a week—to be received. Previously a separate online form was available which submitted responses directly to HMRC and which we understand provided an immediate acknowledgment. This change in practice is very problematic because under HMRC's published guidance at DTTP30610, which has not been updated for the revised online form, receipt of the acknowledgement is what permits the borrower to rely on HMRC's concessionary treatment to use its discretion to pay interest as if the treaty rate applied prior to receiving the formal direction. If the acknowledgement itself is delayed, the use of this concession is significantly undermined, especially where an interest payment date is imminent and the borrower needs certainty that it may lawfully pay gross (or at a reduced rate) in reliance on HMRC's published practice. Even if an acknowledgment is received, the published practice places borrowers in a difficult position, as it is not clear how the borrower would be protected if the clearance is not subsequently issued (for example, if the lender's passport has expired) and backdated to cover the interest payment date. The existence of the concession has nevertheless created a market expectation that borrowers will provisionally pay interest without withholding (and bear the attendant risks).

[1] The practice by which tax which otherwise would be assessed on the UK payer following a failure to operate the withholding of tax is not pursued if it is clear that any tax collected would be repaid to the lender under the terms of a Double Tax Agreement.

2.5. ***Processing times:*** HMRC's stated turnaround time for processing the form DTTP2 is 40 business days (8 weeks). However, members' experience is that processing the form and issuing the direction commonly takes longer than this. But it is also highly variable and unpredictable, with some applications being processed much more quickly and the processing times seem to vary with apparent busier periods. Waiting for the DTTP2 to be processed can create significant practical difficulty where parties are seeking to agree a first interest payment date under a facility agreement, or where a lender has recently acceded to an existing facility. In such circumstances, borrowers and lenders require a reasonable degree of certainty as to when a direction will be received, and the current instances of the 40 business day turnaround being missed make it very difficult to plan commercial arrangements with certainty. In large, syndicated loans it is common for lenders to change frequently, often close to interest payment dates and without notice to the borrower. Even where incoming lenders hold a passport under the DTTP scheme, the processing times of the DTTP2 can cause substantial difficulties, cashflow impacts where the borrower is not able to obtain a clearance in time, and additional tax costs where the borrower is obliged to gross up the lender for such interest withholding tax. A self-assessment system would alleviate these issues, but, in the meantime, it would be helpful if HMRC could consider resource to ensure that the 40 business day processing time is met in substantially all cases (and consider working to reduce it) and consider some communications about typical busy periods when the turnround time is more likely not be met to assist taxpayers and advisers and manage expectations.

2.6. ***Conditions in directions:*** Currently, on completion of the clearance process, HMRC will issue a direction to the payer of the interest that the treaty rate applies. However, the wording of the direction usually contains conditions around the identity of the lender and will cease if there is a change in the residence, status or business details, including changes in name, address or ownership of the recipient of the income (by way of business sale, transfer or merger). While it is understandable that a clearance would cease to apply on a change of residence of the lender, or if the debt is transferred to a different lender, some of the conditions appear unduly onerous, and should not cause treaty relief to cease to be available. For example, change of address of the lender or borrower, company name or ownership. We would like to understand the rationale for these conditions. Do they relate to concerns that HMRC may have about beneficial ownership/treaty avoidance or money-laundering? In practice, most borrowers are not cognisant of such conditions and are unaware of changes in ownership of lenders (or changes to addresses). In large, syndicated loans, borrowers generally only receive a spreadsheet with the name of the lender. A simplification would be a notification obligation which would mean that in cases where treaty relief continues to apply, there is no discontinuity (see 2.7 below).

2.7. ***Uncertainty around "material change"*****:** Our members report that they sometimes encounter uncertainty as to when a new or updated form DTTP2 is required—specifically, what constitutes a "material change" pursuant to HMRC guidance in DTTP30420. It would help if this was clarified to mean a change that leads to a different rate of tax. This uncertainty leads to unnecessary filings (where practitioners err on the side of caution) and, conversely, risks non-compliance where a change is not considered material, but HMRC subsequently takes a different view. A pragmatic approach would be for HMRC to confirm that the information requested on the form DTTP2 defines what is material to HMRC's assessment. In other words: if a particular piece of information is requested on the form, it is material; if it is not requested (for example, the underlying loan agreement is not required to be submitted with a DTTP2 application), it should not be considered material for the purposes of triggering a requirement to file a new or updated form. This would provide practitioners with clear and workable guidance and reduce the volume of precautionary filings.

2.8. ***Uncertainty around revolving facilities***: HMRC's position on the applicability of treaty clearances to revolving facilities is unclear. HMRC have issued treaty clearances in respect of the entire amount of a revolving facility (consistent with the approach to term facilities), and market practice is usually to rely on such a clearance throughout the availability period of a revolving facility. However, some uncertainty exists as to whether, if a revolving loan is drawn down, fully repaid, and then subsequently drawn down again, the subsequent drawdown is a new loan requiring a new DTTP2 application.

2.9. ***Disproportionate consequences of failure***: The consequences of failing to make a DTTP2 application (or of making one late) are heightened and, in our view, disproportionate due to current HMRC practice. Previously, where a borrower disclosed a failure to withhold tax on interest payments to an overseas lender, HMRC would—provided the lender qualified for gross payment or a reduced rate under an applicable double taxation treaty—exercise its discretion not to assess the borrower for the unpaid withholding tax amounts, limiting the consequence to late payment interest. HMRC has temporarily paused this concessionary treatment. With the treatment paused, the consequences of a procedural failure to file a form DTTP2 are materially more severe, notwithstanding that the underlying treaty entitlement to relief may be beyond doubt. A significant knock-on effect arises in the context of M&A transactions. A failure to file a form DTTP2—whether historic or ongoing—can create a withholding tax exposure that surfaces during tax due diligence on a subsequent sale of the borrower entity. With the concession paused, this exposure is no longer merely a matter of late payment interest but potentially extends to the full amount of withholding tax that ought to have been deducted. This can affect deal pricing, require specific indemnity protection, and reduce transaction certainty. These consequences should be seen together rather than as separate, standalone issues. The pausing of the concession amplifies the due diligence risk, and the combination of the two creates a materially disproportionate outcome relative to what is, in substance, a procedural failure where the entitlement to treaty relief is not in question. Self-assessment would mitigate these issues.

2.10. ***Certified claims requiring engagement with two tax authorities:*** Currently all claims for treaty relief required some form of engagement with the lender's tax authority, as well as HMRC. Obtaining a treaty passport under the DTTP scheme requires the completion of a form DTTP1, which needs to be certified by the lender's tax authority. Where a certified claim is required (where the DTTP scheme is not available), the process depends on engagement with both the UK and the overseas tax authority. In practice, this can be very slow, and the timescales are largely outside the control of the taxpayer. Larger clients with established relationships with their local tax authority are at a significant advantage in navigating this process. Smaller taxpayers—who may lack those connections or the resources to pursue the matter through unfamiliar channels—face undue delays and uncertainties. We would encourage HMRC to consider whether the certified claim process could be streamlined or whether alternative evidence of treaty residence could be accepted. Self-assessment with some form of self-certification would mitigate these issues and reduce the administrative burden. Treaty assistance in collection of taxes mitigates HMRC collection risk.

2.11. ***Impact on special purpose vehicles (SPVs) and deal economics:*** Many borrowers in large commercial lending and structured finance transactions are SPVs. Delays in obtaining treaty relief can upset funds flows and deal economics, particularly where the transaction structure has been built on the assumption that interest payments will be made without withholding (or at a reduced rate). In extreme cases, significant unexpected gross-up liabilities—where, as is standard market practice, the procedural risk of obtaining a direction sits with the borrower—could jeopardise the SPV's ability to meet its other payment obligations. This is a real and practical concern in the context of tightly structured transactions.

2.12. ***Unnecessary administrative burden:*** Where tax is withheld and accounted for to HMRC, but the lender was always entitled to treaty relief—the only deficiency being the absence of a DTTP direction—the process of unwinding the position creates unnecessary administration for borrower, lender, and HMRC. The lender must reclaim the tax from HMRC; the borrower may seek reimbursement from the lender of any gross-up amount paid if the loan agreement permits. On standard market terms (based on the LMA recommended form of facility agreement), the borrower's contractual right to have the benefit of repaid tax passed back from the lender is relatively weak and subject to various conditions. This creates a material risk of borrowers being left financially worse off because of excessive administration, notwithstanding that no tax was ultimately due. This outcome is difficult to justify from a policy perspective.

2.13. ***Relationship with the Qualifying Private Placement (QPP) exemption:*** A lender which is entitled to treaty relief will often (provided the parties are not connected and the other conditions, including as to minimum size, are met) be eligible for the QPP exemption. In large, syndicated loans, there is usually no difficulty in meeting the eligibility criteria for the QPP exemption, and the exemption is often available more broadly than treaty relief (as, for example, QPP may provide a full exemption to a lender which is entitled to only a partial exemption from interest withholding tax under the treaty between its jurisdiction of tax residence and the United Kingdom). It is incongruous that smaller loans are subject to onerous administrative procedures for treaty relief, when a lender under a larger loan can often simply give a QPP certificate with no further requirement of DTTP2 filing, certified claim or direction.

3. Proposals for self-assessment basis

3.1. Question 3 – Should UK payers of interest to lenders in jurisdictions with whom the UK have a double taxation agreement be permitted to apply treaty relief on interest payments without prior HMRC clearance? What would be the benefits and risks of this? Question 4 – How would moving to self-assessment of treaty relief benefit your business (such as time saved, reduction of fees, cash-flow improvements, greater certainty)? Question 5 – Do you have a view on how interest payers would satisfy themselves that all the requirements for treaty relief are met before applying treaty relief to payments? What experience do you have in other jurisdictions where self-assessment of treaty relief is possible? How well does this work?

3.2. We suggest that a self-assessment regime could work well around a self-certification mechanism, under which the lender would issue a treaty passport certificate directly to the borrower. The certificate would confirm that the lender: is resident for tax purposes in its jurisdiction of incorporation or establishment; beneficially owns the interest to which it is entitled under the relevant facility; and has fulfilled all conditions required under the applicable double taxation treaty for the treaty rate to apply to interest payments made to it. We suggest that HMRC retains the DTTP scheme so that the lender can continue to hold a treaty passport (registered with HMRC), and the borrower could verify the passport's validity via HMRC's published treaty passport register. A mechanism along these lines would avoid the need for any application to, or paperwork from, HMRC in respect of each individual loan.

3.3. To reduce the due diligence requirements on the borrower, the certificate should be treated as valid and effective unless and until: (a) the lender informs the borrower that the confirmations contained in the certificate are no longer true and accurate; or (b) HMRC (as part of an enquiry) gives notice that the certificate is not valid. This is analogous to the position of a creditor certificate provided under the qualifying private placement exemption (a QPP creditor certificate).

3.4. We understand that this approach is broadly similar to the system operating in Ireland, which in our members' experience works well in practice. We acknowledge that Ireland may benefit from broader domestic exemptions (particularly for EU lenders) which reduce the volume of claims requiring oversight, and we recognise that HMRC have expressed their desire to maintain oversight of treaty reliefs. Also, we appreciate that the risk of a pure self-assessment system is greater for payments of interest than with royalties, simply because the number of interest payments must dwarf the number of royalty payments.

3.5. Therefore, if HMRC considers that a pure self-certification model provides insufficient oversight, a solution could be self-certification with after-the-fact notification.

3.6. Under such a self-certification system, the self-certification mechanism described above would operate to make treaty relief available immediately upon issue of the certificate by the lender to the borrower; but HMRC would be notified (within a reasonable period—for example, 30 days) that a relevant loan has been entered into and that a certificate has been issued. Under this model, HMRC's ability to enquire into higher-risk transactions would be preserved, but the notification itself would not affect the availability of relief. This would ensure that taxpayers are not disadvantaged by HMRC processing times whilst maintaining HMRC's ability to exercise appropriate oversight.

3.7. Similarly to the QPP scheme, it should be sufficient that the borrower holds a certificate given by or on behalf of the beneficial owner(s) of the interest. This would facilitate the payment of interest to partnerships and tax transparent vehicles, which may have many passive limited partners / beneficial owners and on whose behalf a fund manager will usually handle administrative matters. Some risk would remain for borrowers under such a system in case of a change in the beneficial owner of interest of which the borrower is not aware.

3.8. We also suggest that consideration is given to expanding the certification scheme to allow companies resident in the Crown Dependencies to qualify, as now they do not due to their Double Tax Agreements not having the correct non-discrimination article. A creditor certificate could include a statement to the effect that they meet one of the exempt beneficial ownership conditions listed in the Double Tax Agreements. This would put the treatment of interest on a par with royalties, where the self-assessment system already includes that by allowing the payer to conclude that the recipient meets one of the criteria and pay royalties gross.

3.9. Question 6 – Should self-assessment of treaty relief only be available where the risk of base erosion is low because the payer is subject to other effective restrictions on interest deductibility? If so, what would be a good basis for a threshold (such as being subject to transfer pricing rules, having net finance costs exceeding the de minimis for Corporate Interest Restriction, being subject to Pillar 2, or some combination of these)?

3.10. Any such mechanism should clearly not infringe the non-discrimination provisions of Article 24(4) of the OECD and UN Model treaties.

3.11. We suggest that notification of relevant loans would address HMRC's legitimate concerns regarding tax avoidance using connected parties in tax havens. We do not think that there should be a threshold because including one would inevitably introduce complexity and another cliff edge into the UK tax system.

3.12. We suggest that the compromise proposed above of requiring a notification to HMRC should provide HMRC with oversight of loans where there is an increased risk. In addition, it may be possible to adopt the approach of the QPP exemption which does not allow connected parties to benefit.

3.13. Question 7 – Would it be necessary or helpful to introduce a facility for interest-payers to obtain certainty in advance of paying interest that HMRC agrees treaty relief is available? How might such a facility work? Are you aware of other jurisdictions providing such a facility?

3.14. We do recognise that, setting aside the uncertainties (highlighted above) that can arise in relation to the application of conditions in the directions for gross payment and whether changes are material, the current processes do provide for certainty for borrowers once they have received approval to pay the interest gross.

This certainty would be removed from a self-assessment system, at least to the extent it is not possible to rely on a certificate equivalent to a QPP certificate.

3.15. For certain types of transactions, a pre-approval or clearance mechanism (like existing HMRC advance clearance procedures) could be valuable. We recognise that this would not suit most syndicated lending transactions, given the pace at which such facilities are documented and the frequency with which lenders accede to and transfer out of syndicates. However, a clearance mechanism could benefit specific transaction types — such as private securitisations — where the current DTTP process necessitates specific and often complex drafting to delay payment on notes until a direction has been received. A pre-approval mechanism could remove this friction and simplify the documentation.

3.16. Question 8 – Are there other jurisdictions you have experience of where the administrative burden to obtain treaty relief is low, but the regime still provides effective protection against base erosion using interest? What are the requirements in such jurisdictions when paying cross-border interest? How is protection against base erosion achieved (particularly for owner-managed businesses)?

3.17. As noted above, our members report that the system in Ireland works well.

3.18. Question 9 – Do you have any comments on the potential impacts of these changes on tax receipts or avoidance/evasion behaviour? We are especially interested in how businesses and lenders might respond to changes.

3.19. A self-assessment system with appropriate oversight from HMRC should not have significant impacts on taxpayer behaviour. The underlying aims are to reduce the administrative burden for taxpayers and HMRC in arriving at a position of correctly applying treaty relief to remove or reduce the requirement to withhold income tax on payments of interest to overseas lenders.

4. Reporting requirements

4.1. Question 10 – What reporting requirements are imposed in other jurisdictions in which you have significant operations/investments? Question 11 – Would it be significantly burdensome to report payments made with complete relief (so that no UK tax is due) in the CT61, alongside payments made without relief or with partial relief? Would it be preferable instead to report them alongside treaty rated cross-border royalty payments in the CT600H? Why?

4.2. There are pros and cons in both approaches. The CT61 is probably familiar to most taxpayers so could be preferred for that reason. However, there are likely to be more payments with complete relief than payments without relief or partial relief, so increasing the amount of reporting that would be required four times a year. Also, the CT61 is one of the more outdated elements of the corporate tax system – the form looks very old fashioned, and it is also anomalous that these forms go to a different part of HMRC than the company's corporation tax office. On balance we suggest that annual reporting as for cross-border royalites would be the preferred approach for an interest self-assessment regime.

4.3. In either case the reporting requirements should be dovetailed with, and not duplicated by, the reporting requirements of the standardised CT computation, as that is developed.

4.4. If a borrower is expected to report all interest payments, and not just payments subject to withholding, consideration should be given to a standardised electronic reporting format which can be submitted multiple times in respect of the same reporting period. If adopted by loan agents, the administrative burden on borrowers may be eased if loan agents are able to supply records of interest payments in the necessary format.

5. Penalties and sanctions

5.1. Question 12 – What sanctions are imposed in other jurisdictions in which you have significant operations/investments? Question 13 – What would be a proportionate but effective set of sanctions for non-compliance in this area?

5.2. The sanctions should recognise the potential risk for tax avoidance, and, we suggest, as for royalties, permit assessment back to day one where payment is made incorrectly in accordance with existing self-assessment rules.

5.3. However, given the prevalence of gross-up clauses in commercial lending, a decision by HMRC to seek recovery of withholding tax from the borrower is akin to a penalty (because the borrower probably will not be able to recover the tax from the lender, but it is the lender's income, not the borrower's). We suggest, therefore, that, if a borrower holds a (self-certified) certificate of residence from an unconnected lender, and has no reason to suspect that the certificate was fraudulently or negligently given, there should be no right for HMRC to seek recovery of the tax from the borrower, and therefore no late payment interest or penalties.

6. Other options

6.1. Question 14 – Are there any other options or ideas for simplifying the withholding process on interest that you believe the government should consider? This could include international examples not mentioned above, or innovative uses of technology or data sharing. Question 15 – Do you have any other comments in relation to changes which could be made to the current system for withholding on payments of interest and how these would impact (positively or negatively) to your/your clients' organisation? This may be in the form of time saved per transaction, reduction in fees, cash-flow.

6.2. We do not have any suggestions for other options in addition to those outlined above.

7. Acknowledgement of submission

7.1. We would be grateful if you could acknowledge safe receipt of this submission and ensure that the Chartered Institute of Taxation is included in the List of Respondents when any outcome of the consultation is published.

8. About us

8.1. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.

8.2. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

8.3. The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries.

8.4. Our members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

The Chartered Institute of Taxation
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