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Securitisation and Derivatives: United Kingdom Tax Update

Adam Blakemore

Cadwalader, Wickersham and Taft

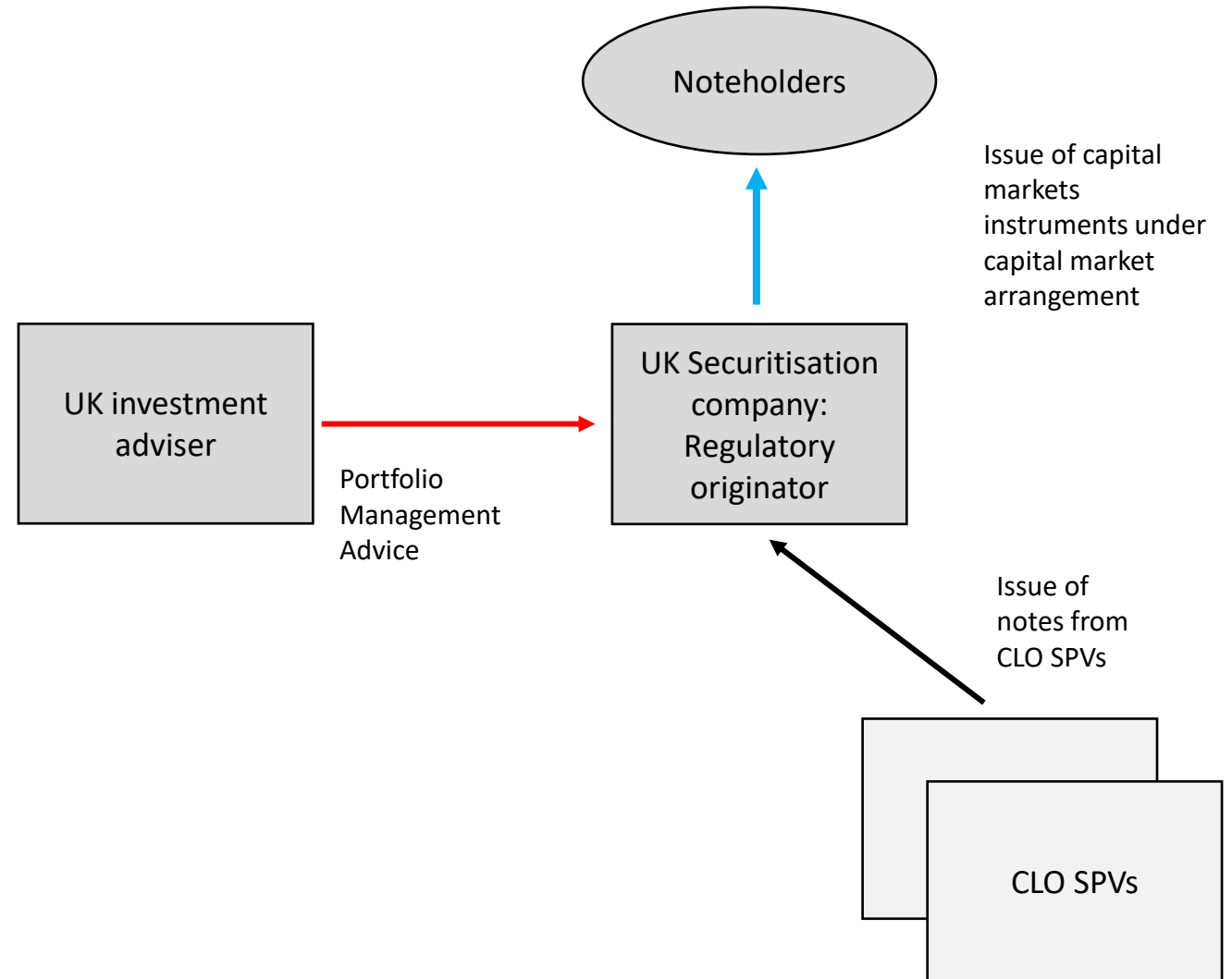


United Kingdom – Securitisations and NPLs

- UK taxation of securitisation companies
 - The Taxation of Securitisation Companies Regulations 2006 (the “**Regulations**”)
 - recent HMRC consultation and changes in law: May 2022 (SI 2022/465)
- Activities of a securitisation company within the Regulations
- Lifecycle of assets being securitised
- Non-performing loans

United Kingdom – SPVs and securitisation transactions

- Companies used in UK securitisation transactions:
 - PLC or limited company
 - tax residence
 - tax ‘substance’
- Scope of activities:
 - “apart from any incidental activities”
 - “acquiring, holding and managing financial assets forming the whole or part of the security for a capital market arrangement” (Regulation 5(5))
- Regulatory-compliant activities?
- Typical 2022 transactions
- International comparisons
- TSCR-qualifying company or a UK Qualifying Asset Holding Company?



United Kingdom – Derivatives and Beneficial Ownership

- English law, EU Directives, OECD Model Tax Convention and HMRC guidance:
 - HMRC’s guidance: Beneficial ownership is defined as “**the sole and unfettered right to use, enjoy or dispose of**” the asset or income in question (INTM 332010: ‘*Double Taxation Claims and applications: Beneficial ownership: What beneficial ownership is*’)
- The “Danish Cases”: *T Danmark* (Case C-116/16) and *Y Denmark* (Case C-117/16) (and others)
 - concepts of “economic reality” and “abuse of rights”
- UK tax treatment of derivatives in the context of beneficial ownership:
 - withholding taxes on interest or annual payments
 - application to derivatives
 - comparison to sub-participations and other contractual payments

United Kingdom – Derivatives and Cryptoassets

- Assets being securitised by UK securitisation companies
- In conjunction with the proposed “Edinburgh Reforms” (in December 2022), UK Government has confirmed that the “Investment Transactions List”, relevant for the UK’s investment manager exemption, will be expanded to include cryptoassets
- Definition based on the OECD’s Crypto-Asset Reporting Framework
- Inclusion of cryptoassets in portfolios of offshore funds managed in the UK
- But what about UK securitisations under the Regulations?
 - paragraph 9A of the Regulations
 - “derivative contracts”
 - “acquiring, holding and managing **financial assets** forming the whole or part of the security for a capital market arrangement”
 - IFRS and principles-based approach to cryptoassets accounting: debt security, equity security, intangible asset...?



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Thank you

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A&L Goodbody

IBA Finance and Capital Markets Conference

London 16-17 January 2023

Current Developments affecting the securitisation and derivatives markets

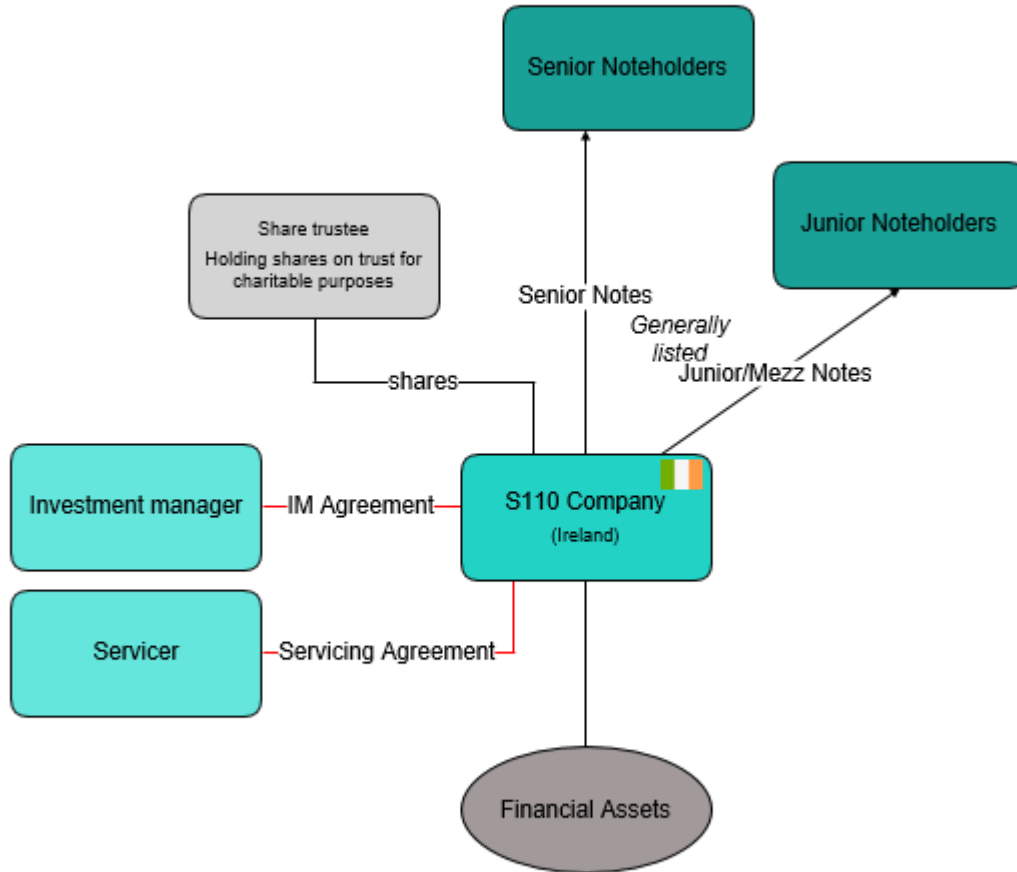
Irish tax update

James Somerville – A&L Goodbody LLP



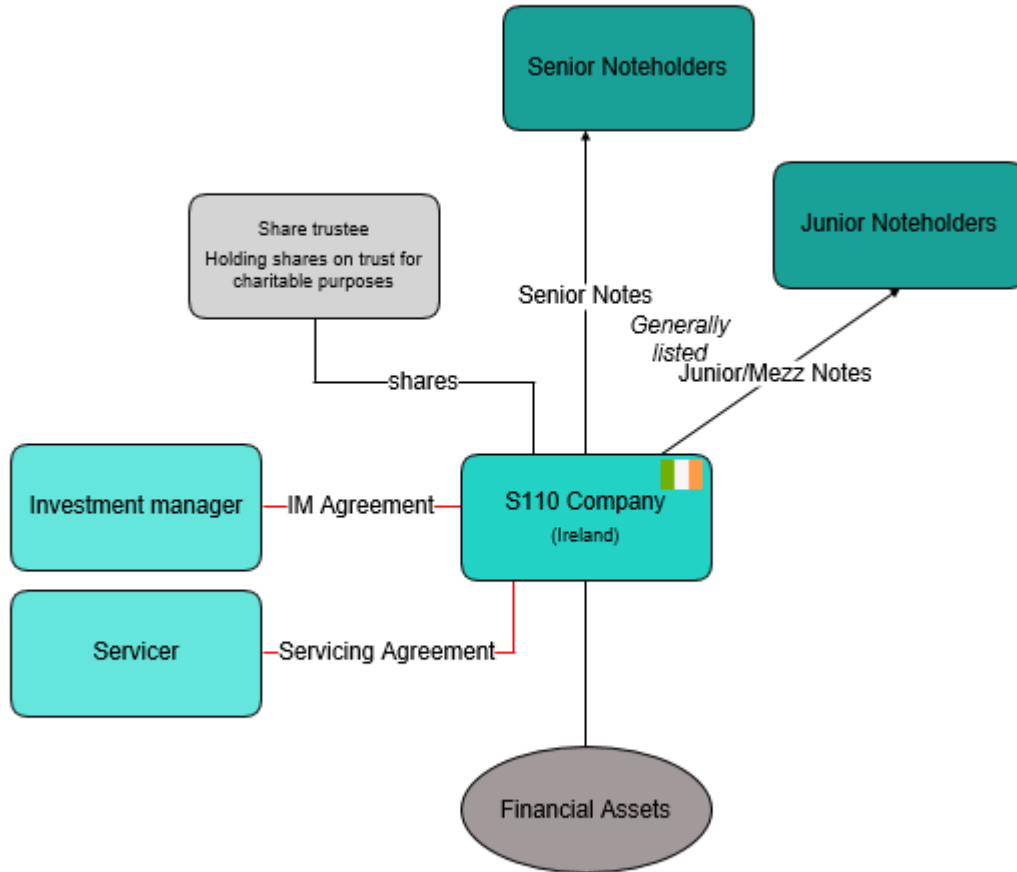
Irish securitisation special purpose vehicles

The 'Section 110' Company



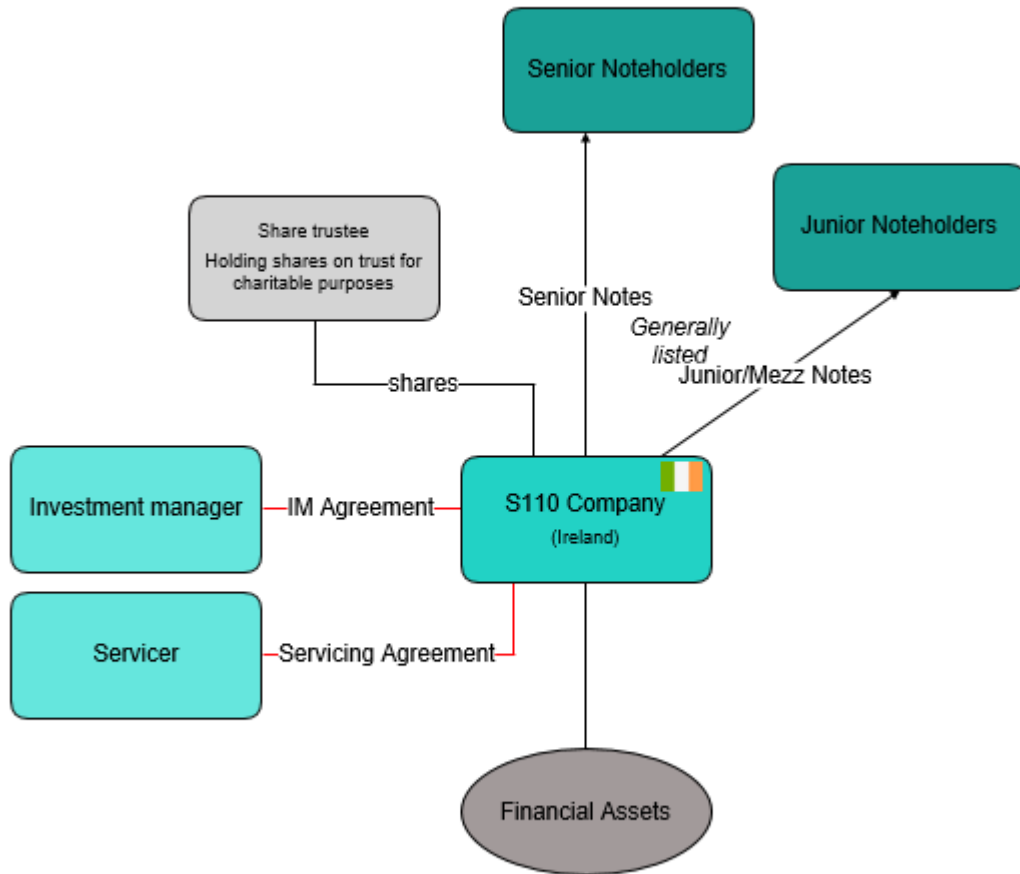
- “Normal” Irish Company
- Taxed under special taxation regime in section 110 Taxes Consolidation Act, 1997 which in most circumstances facilitates tax neutrality
 - *Taxable on profits at 25% rate of corporation tax but able to calculate profits as if trading – taking deduction for all finance costs*
 - *Normal rule that denies tax deductibility for ‘profit dependent’ or excessive interest is “switched off”*
 - *VAT exemption for investment management and servicing fees under the management of special interest funds exemption*
 - *Broader interest withholding tax exemptions*
- Interest withholding tax and specific tax deductibility rules to navigate – commonly listing of the notes addresses this with unconnected investors.
- Enhanced tax deductibility restrictions where for profit dependent interest where (i) underlying assets are Irish mortgage loans or (ii) noteholders “control” the s110
- Overlay of ATAD anti-hybrid rules and interest limitation rules.

ATAD restrictions



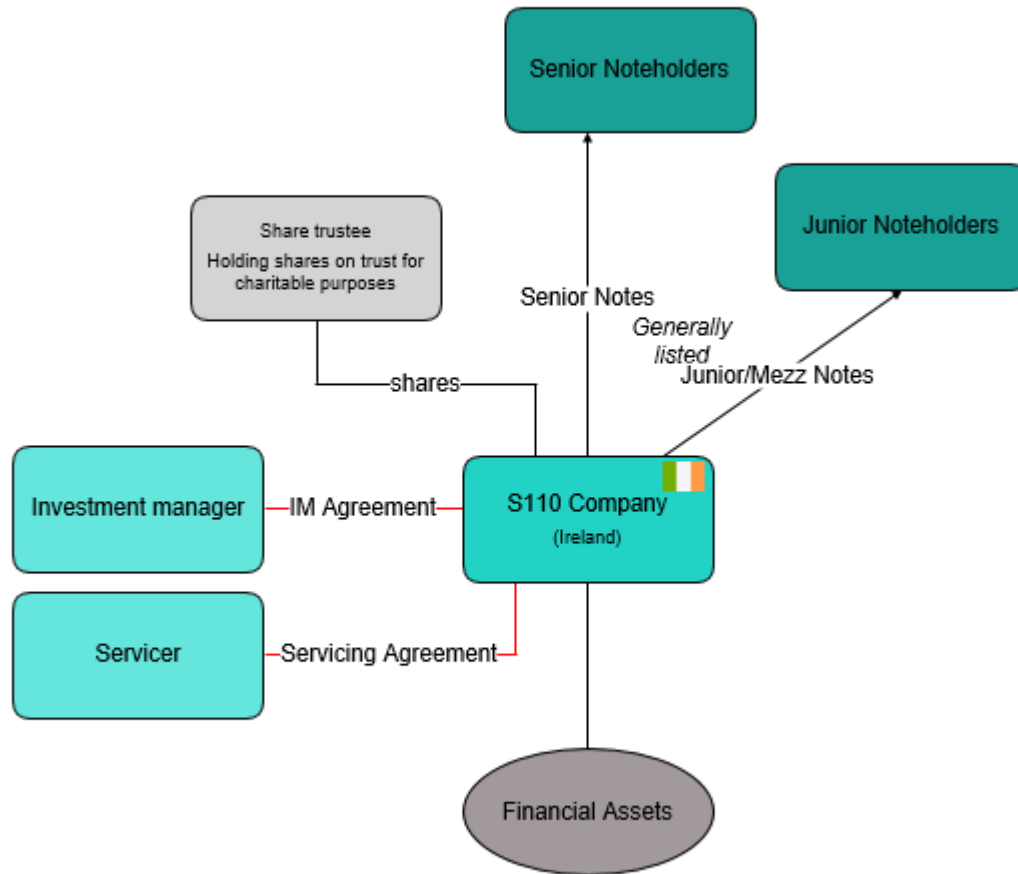
- Anti-hybrid rules – post 1 January 2020
 - Normally s110 company is orphan entity – shares held on charitable trust
 - So generally doesn't have associated enterprises unless
 - the s110 is consolidated from an accounting perspective with another entity under Irish GAAP or IFRS, or
 - where another enterprise has 'significant influence' in the management of the other enterprises – defined as an ability to participate in board of directors in financial and policy decisions
- Interest Limitation Rules – post 1 January 2022
 - Ireland had deferred implementation to this date
 - Brought in in 2022 and guidance published by Irish Revenue Commissioners
 - In principle potentially problematic – as tax neutrality of s110 is dependent on full interest deductibility but two principal analyses either
 - there is no “excessive” interest being paid – all income is interest or interest equivalent
 - outside scope of rules as a result of being a “single company worldwide group”.

Interest equivalent concept



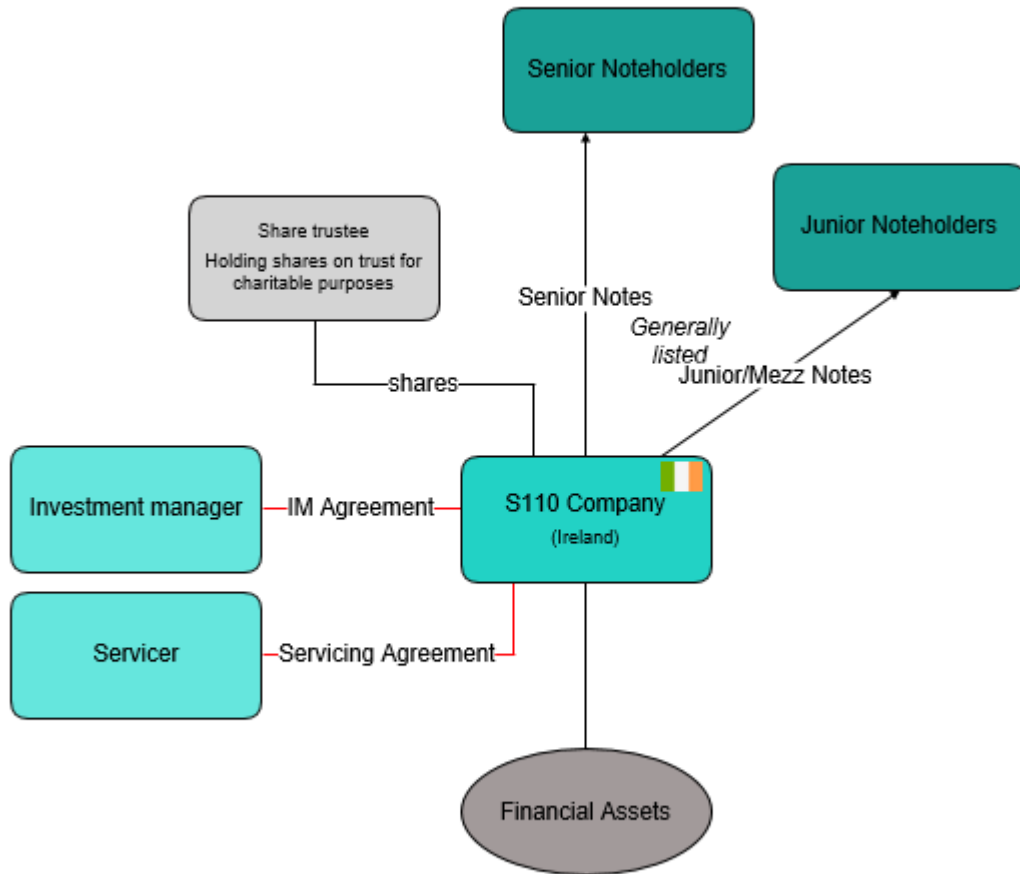
- Legislation and Guidance clarify treatment of
 - Discount
 - Finance element of finance and operating lease receipts
 - Amounts under derivative/hedging instruments connected with raising of finance
 - Guarantee fees/commitment fees
 - Fx gains and losses on interest amounts
 - Portion of profits and losses on financial assets/liabilities to the extent “reasonable” to consider such amounts are economically equivalent to interest
- NPL treatment
 - Guidance says take expected cashflows on acquisition and IRR returns should be considered interest equivalent
 - However if improved recovery the excess not likely to be considered interest equivalent. If deterioration in return may generate deductible interest equivalent ‘expense’

Interest equivalent concept



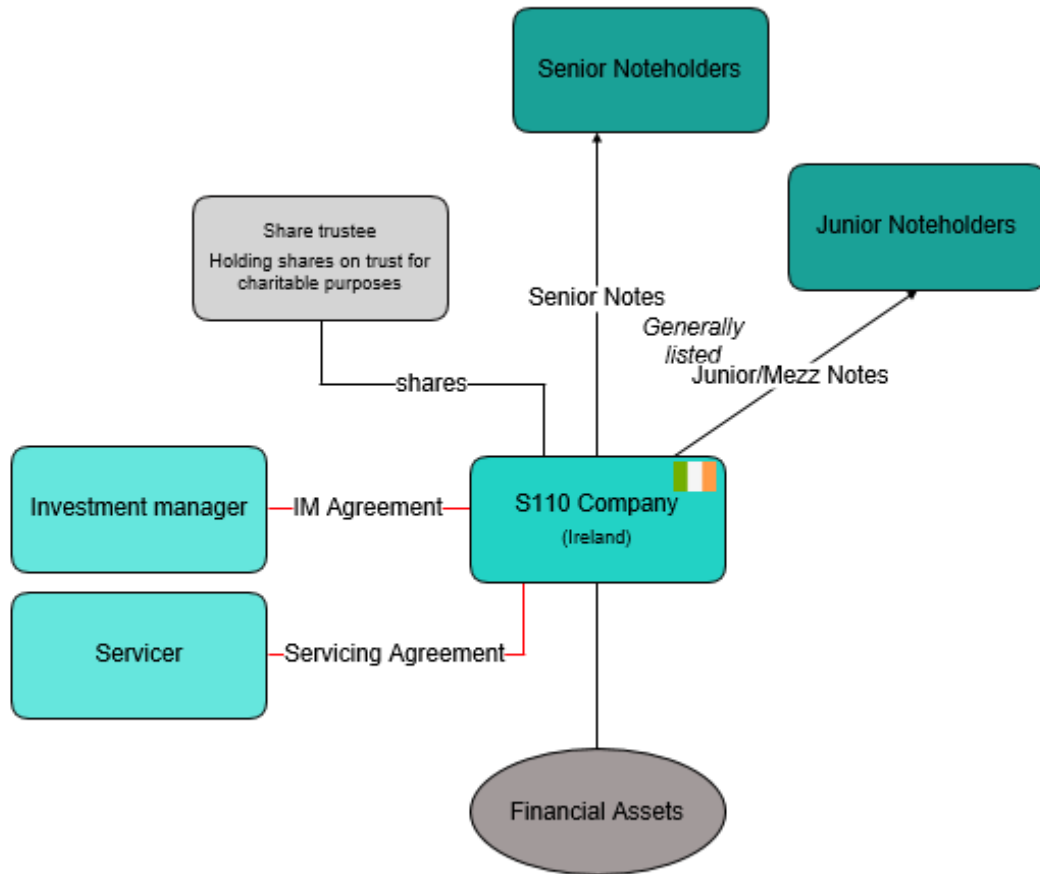
- If NPLs converted on work out to equity or other assets these can be held and impairment loss should be considered deductible interest equivalent. But if gain in excess of original expected financing return is realized unlikely to be interest equivalent
- Other guidance and examples dealing with :
 - Standard securitisation
 - Synthetic securitisation
 - Repo transactions
 - Commodities
 - Islamic finance
 - Stock lending
 - Receivables factoring

Single Company Worldwide Group concept



- Due to manner in which s110s are generally orphaned, through having all shares held by trustee on trust for charitable purposes, not technically a 'stand alone' entity within Directive but also not in a 'group' in normal sense so not able to avail of group treatment
- Concept of SCWG included - so neither a stand alone entity nor a group member and should not be disadvantaged
- Can apply group treatment on a notional basis and adopt group/equity ratios provided not paying interest to associated enterprises – using anti hybrid definition.
- So true orphan entities generally do not suffer interest restrictions under ILR.

Derivatives and beneficial ownership



- No specific Irish rules re derivatives
- Bondwashing restrictions combatting conversion of income into gain when selling securities with coupon entitlement
- Specific tax rules in relation to repos and stock loans of 12 month duration or less – but generally not relevant to section 110 company as these are separately taxed as if trading on basis of accounting results
- There are anti-avoidance provisions where loans/repos are in place over dividend/coupon payment dates.



Thank you

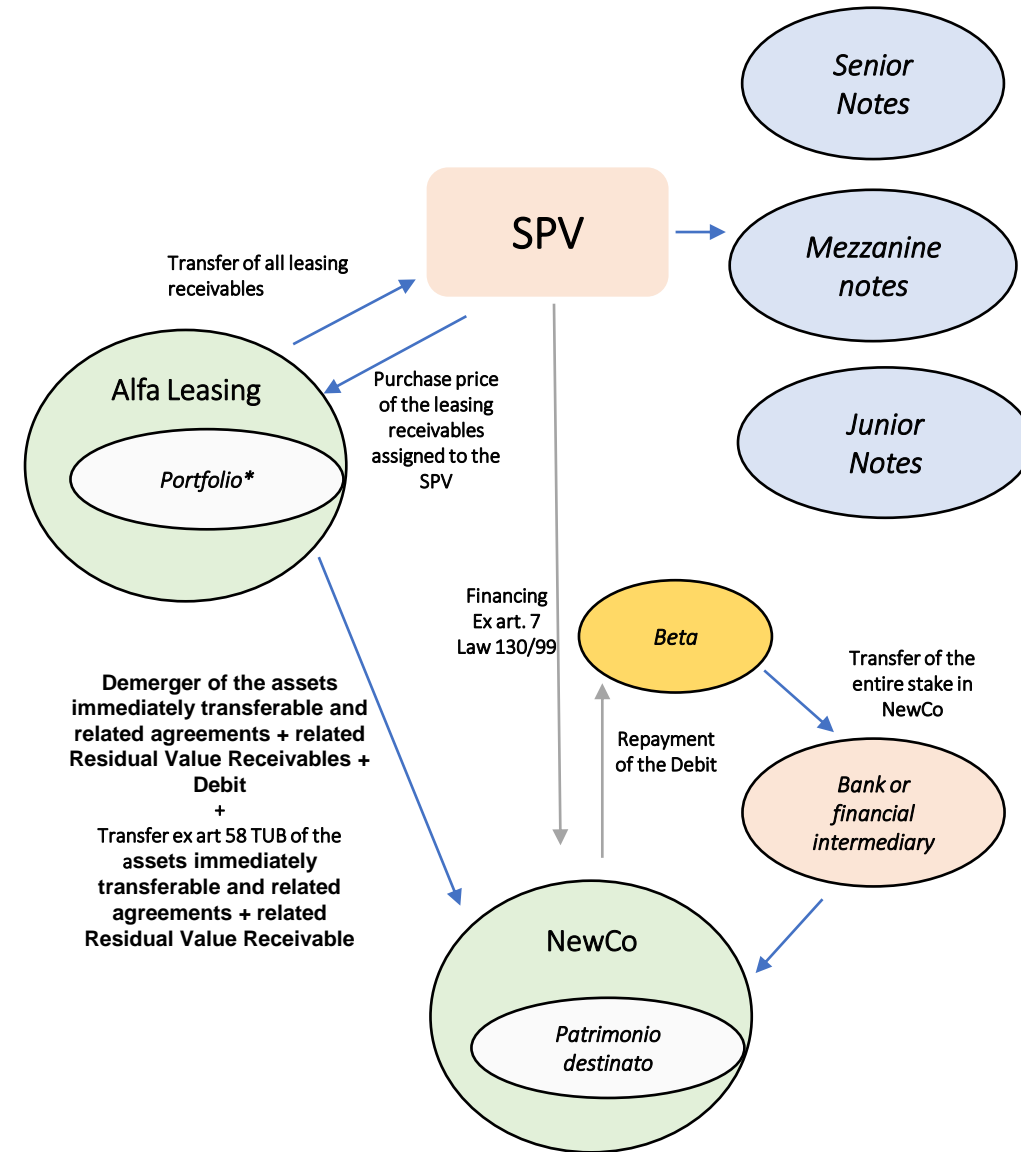
Proposed transaction on performing real estate leasing

The proposed transaction is composed of the following transactions:

- (A) Transfer of receivables under Law 130/99 from Alfa Leasing to an SPV;
- (B) Demerger from Alfa Leasing to a newly incorporated company (the "NewCo");
- (C) Transfer pursuant to Article 58 of the Consolidated Banking Act from Alfa Leasing to the NewCo;
- (D) Granting of a limited recourse loan from the SPV to the NewCo; creation by NewCo of a segregated portfolio ("*Patrimonio Destinato*") pursuant to Article 7, paragraph 2-octies, of Law 130/99 and Article 4-bis of Law Decree no. 162 of 30 December 2019.

In particular:

1. Transfer under Law 130/99 of all the leasing receivables (other than the Residual Value Receivables, see below) to an SPV incorporated under Law 130/99.
2. Demerger of: (1) the real estate assets not immediately transferable ("*beni immobili non rogitabili*"); (2) the related real estate lease agreements; (3) the relevant Residual Value Receivables, and (4) a portion of the existing financial liabilities of Alfa Leasing towards Beta for an amount equal to the evaluation of the Residual Value Receivables (the "Debit"), where "Residual Value Receivables" means the receivables arising in connection with the option to purchase the asset at the end of the contractual term under any leasing agreement; the partial demerger would be carried out by assigning shares of the NewCo to the sole shareholder of Alfa Leasing, Beta (the "Demerger").
3. Immediately following the completion of the Demerger, Beta will transfer to a third-party bank/financial intermediary the entire stake in NewCo assigned to it in the context of the Demerger.
4. Transfer in favor of the NewCo pursuant to Article 58 of the Consolidated Banking Act of: (1) the real estate assets immediately transferable ("*beni immobili rogitabili*"); (2) the related real estate lease agreements; and (3) the relevant Residual Value Receivables.
5. Disbursement by the SPV to the NewCo of a loan pursuant to Article 7, paragraph 1, letter a) of Securitisation Law (the "**Limited Recourse Loan**"); the repayment of this loan will be limited recourse on the proceeds deriving from the assets/receivables included in the *Patrimonio Destinato* (as defined below).
6. Creation within the NewCo of a segregated portfolio ("*Patrimonio Destinato*") pursuant to Article 7, paragraph 2-octies, of Law 130/99 and Article 4-bis of Law Decree no. 162 of 30 December 2019 including the real estate assets, the related agreements and the Residual Value Receivables.
7. Payment by the NewCo through the proceeds deriving from the Limited Recourse Loan of (1) the Debit to Beta and (2) the purchase price of the transfer pursuant to Article 58 of the Consolidated Banking Act to Alfa Leasing.
8. Issuance by the SPV of different classes of Notes.



*of leasing receivables, agreements, real estate assets and the Debit

Securitization and Derivatives The Netherlands Tax Update

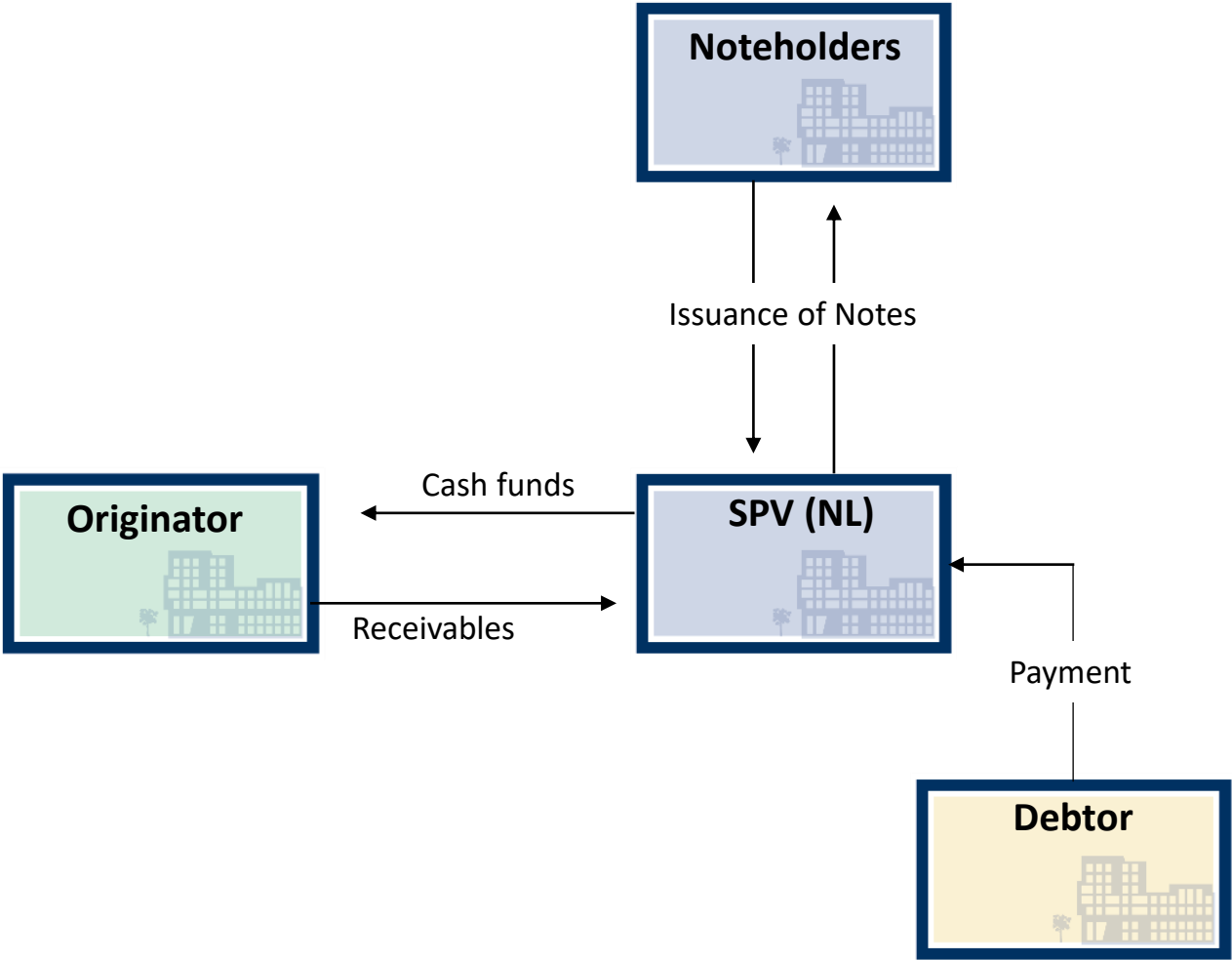
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January 2023



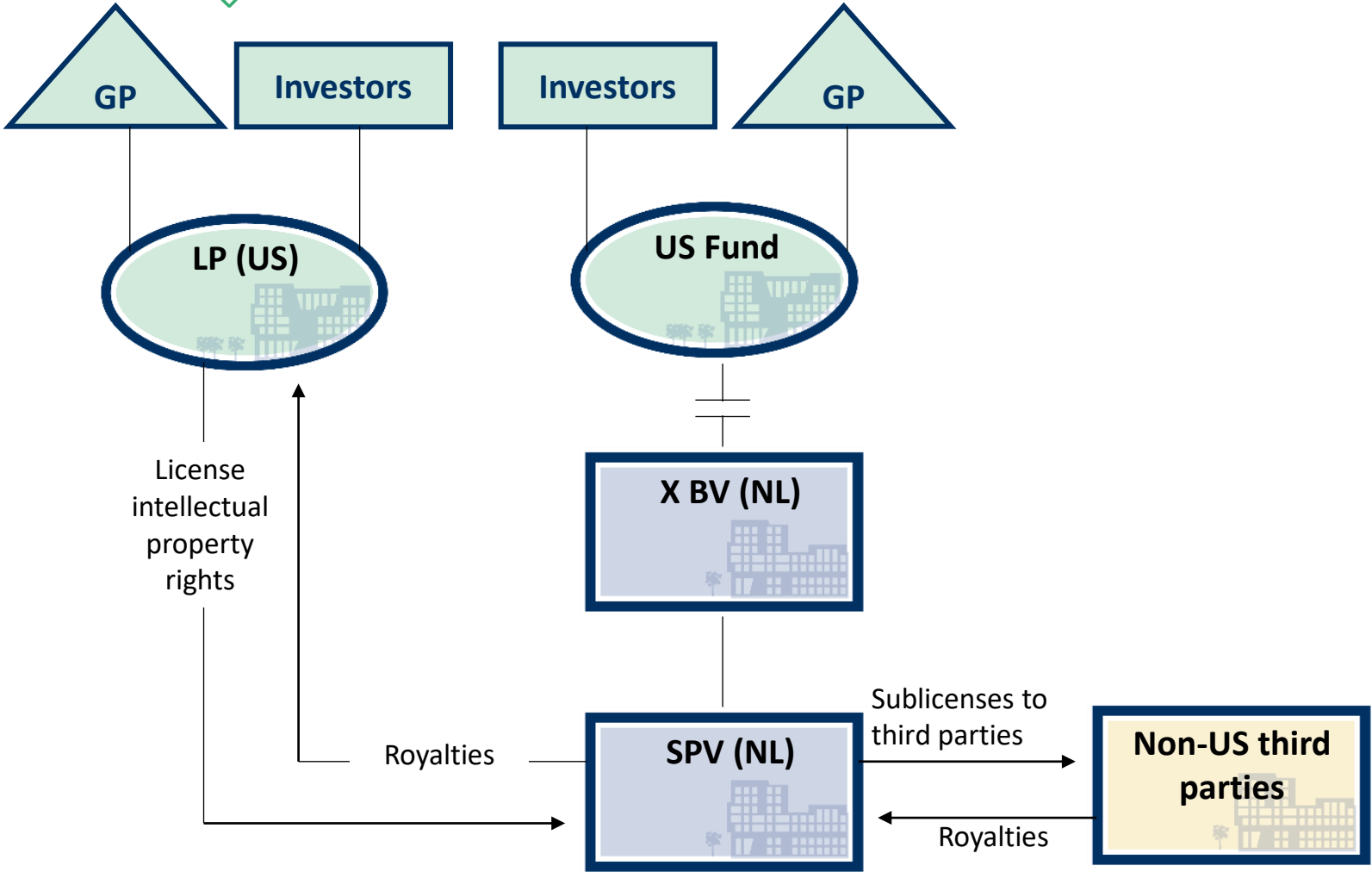
Reinout de Boer

Recognition of NPL losses



- Key issues:**
- **Deferred purchase price of the assets**
 - **Beneficial ownership**
 - **Limited recourse w/r/t Notes?**
 - **Guarantee issued by Originator?**

Case study - securitisation



- Key issues:**
- (Conditional) withholding taxes:
 - Payments by the SPV.
 - Payments to the SPV.
 - Beneficial ownership
 - Substance at the level of the Dutch entities
 - Remuneration of the SPV.

Update on dividend-stripping in the Netherlands

- Public consultation on possible amendment of anti-dividend-stripping rules
 - Introduction of a net income/base-approach for a tax credit or refund for purposes of the Dutch dividend withholding tax.
 - Comprehensive documentation requirements.
 - Codification record date.
 - The introduction of a statutory provision stating that the economic interest in the shares only exists if a person (independently, or together with an affiliated entity), owns the entire economic interest.
- Expected timing: 1 January 2024 (or later..).
- Proposal of the European Commission to be expected early this year to improve withholding tax procedures for non-resident investors.

Recent developments on interest rate swaps

- Case law Dutch Supreme Court (2022) on redemption of interest rate swaps



Fixed rate loans in case of falling market interest rates

- Deductions only for agreed annual interest
- Loan remains @ nominal value



Premium interest adjustment for fixed-rate loan

- Not deductible at once
- Capitalization & amortization



Early repayment of fixed-rate loan resulting in a new substitute loan

- Not deductible at once
- Capitalization & amortization
- Substitute loan? → to be assessed according to circumstances



Variable rate loan combined with interest rate swap, termination of loan and surrender of interest rate swap

- Surrender charge of swap may be deductible as lump sum in current year



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Securitization and Derivatives

US Tax Update

January 16, 2023

11:45 – 12:30

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Latest Update on Cryptocurrency Tax Reporting

- **US tax legislation expanded tax reporting for brokers who facilitate cryptocurrency transactions for transactions undertaken in 2023 and after.**
 - **The question as to who constitutes a broker for this purpose has generated considerable Congressional and industry attention**
- **2021 US tax legislation also mandates tax reporting for persons who accept cryptocurrency as consideration for goods & services, beginning with 2023 transactions.**
- **In late December 2022, the US Internal Revenue Service delayed the implementation of new reporting rules until it issues final regulations. IRS Announcement 2023-2.**

Innovative Pharmaceutical Funding Transactions are Gaining Traction

- **US pharma funds are now providing funding to pharma start-ups in exchange for a percentage of revenues from sales of specific pharmaceuticals.**
- **Transactions are unlikely to be characterized as either debt or equity in the pharma company. Most likely US tax characterization is a joint venture.**
- **Joint venture formats raise the possibility of non-US partners in the pharma fund earning income that is subject to net US tax.**
- **Possible derivative structures to avoid US tax.**

IRS adds Hedge Fund Lending to List of High Priority Items for Audits

- **Credit funds & offshore insurance companies can receive US-source interest free from US withholding tax.**
 - **Portfolio interest exception does not apply if the interest income is received in connection with the conduct of a US trade or business of lending**
- **If a credit fund becomes too involved with the loan origination, it can be treated as engaged in a lending business.**
- **In mid-2021, the IRS decided to make the issue of lending vs. buying secondary market debt an audit priority issue.**

Litigation Funding – Derivative Use is Becoming an Industry Standard Financing Technique

- **Recent US tax case recharacterized transaction structured as debt as a prepayment for services.**
- **Case likely means that persons providing financing are receiving income that constitutes US trade or business income.**
- **Industry has responded by changing funding structures to use derivatives that should not generate US trade or business income.**
- **No IRS response as of yet. Effectiveness could hinge who is being funded and the underlying claim.**

2023 Withholding Rules Threaten Publicly-Traded Partnership Trading Outside of the US

- **Beginning in 2023, brokers clearing market transactions in companies treated as partnerships for US tax purposes are required to withhold US tax if partnership is engaged in the conduct of a US trade or business.**
- **PTPs can be both US companies trading shares outside of the US or non-US companies that have elected partnership treatment for US tax purposes.**
- **Brokers & Euroclear refuse to accept liability for US tax withholding even if PTP has no history of US trade or business income.**

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