<u>Simplifying Treaty Relief from Withholding Tax on Interest Paid Overseas</u>

<u>Consultation Response by Simmons & Simmons LLP</u>

1. <u>Introduction</u>

1.1 Simmons & Simmons LLP welcomes the opportunity to respond to HMRC's consultation on *Simplifying Treaty Relief from Withholding Tax on Interest Paid Overseas*, published on 13 July 2026 (the "**Consultation**").

1.2 Simmons & Simmons LLP is a leading international law firm with offices in major business and financial centres throughout Europe, the Middle East, Asia and the United States.

1.3 The corporate loan market has changed materially in recent years. In the past, UK banks were the mainstream lenders to UK borrowers and overseas lenders were typically overseas banks, each requiring a simple, single treaty clearance with which their personnel were familiar. Funds are now increasingly parties to finance transactions, as both lenders and borrowers, and changes in the lender group during the term of a loan are much more common than they used to be, as are very large syndicates. These developments have materially increased the significance of complexity and delay in the clearance process.

1.4 However, we are also aware that the UK system is longstanding and that a reasonably settled practice of risk allocation and procedures around UK withholding tax has developed, particularly in the LMA standard documentation. In our view, it is preferable to simplify and streamline this established framework rather than to depart from it entirely or to add another layer to it.

1.5 We have aligned our responses to the questions set out in the Consultation.

1.6 We would be happy to participate in further formal or informal discussions in relation to the subject matter of this Consultation.

2. <u>Summary</u>

2.1 In our opinion, the most important points to consider in the Consultation are as follows:

(A) Given taxpayers' and advisers' familiarity with the current system, it may be better to reform key aspects of this, rather than to depart from it entirely or add another layer of compliance. Whilst in principle we support a move to self-assessment, the risks of doing so must be carefully managed.

(B) As an example of this concern, in the context of the large corporate loan market, placing the risk of an incorrect self-assessment solely on the borrower would be unsatisfactory and could result in the benefits of a streamlined system being outweighed by the cost of extensive negotiations between lenders and borrowers.

(C) The Consultation's aims are only likely to be met if borrowers benefit from clear rules whereby, if they obtain specified evidence at the time the loan is made, they are not at risk of HMRC pursuing them for tax which has not been withheld. Practical solutions include a modified treaty passport scheme and/or lender self-certification modelled on US W-8 forms or the UK qualifying private placement regime.

(D) Developments internationally, including the proposed introduction of the EU Taxation Omnibus package, which would exempt interest payments between European companies from withholding tax except in limited circumstances, indicate that retaining stringent administrative processes could make the UK an outlier.

(E) The outcome of this Consultation must be properly aligned with the outcome of the review of the HMRC concession on late-claimed treaty relief, so that there is no gap in protection for taxpayers between the two workstreams.

3. <u>Responses to Questions</u>

Question 1 – Delays, costs and administrative burdens

3.1 The Form DT process causes delays through HMRC processing times and input from overseas tax authorities, and is administratively burdensome given the detailed information required.

3.2 In practice, interest payments are often deferred (for example through the commonly adopted "long first interest period") where clearance will or may not be in place in time, which is preferable to the burden of paying withholding tax and then reclaiming, but the ability to defer may not always be possible or commercially attractive. We also see the qualifying private placement (QPP) regime being adopted on an interim basis pending receipt of a formal treaty direction, although this approach is not available to all lenders.

3.3 In our experience, restructurings can give rise to particular difficulties. By way of example, a debt-for-equity swap may result in shares being issued in discharge of accrued or capitalised interest, potentially crystallising a withholding obligation earlier than originally expected in a deal timetable that does not allow for new clearances to be obtained.

3.4 A related issue is that clearances are currently sent only to borrowers, which can mean that lenders and their advisers lack visibility on clearance status. In a syndicated context this can create practical difficulties, particularly following transfers where the incoming lender may need to understand the clearance position.

3.5 While the treaty passport scheme has been a welcome improvement, delays arise both in the DTTP1 and DTTP2 processes. The need for new clearances on amendments, even relatively minor ones, adds further burden, and can create bear traps for borrowers and lenders who are not aware of the circumstances in which HMRC would consider a relevant amendment to have occurred.

3.6 One specific aspect of the current process which we consider unnecessarily restrictive is the requirement for a signed facility agreement before a treaty claim or DTTP2 application can be made. In practice, the details required for such an application — the identity of the parties, the maximum facility amount and the beneficial ownership of the interest — would often all be available at the outset of negotiations, and certainly in advance of execution. Allowing applications to be submitted at that stage, with the executed facility provided subsequently for completeness, would meaningfully reduce the period during which borrowers are exposed to clearance-related uncertainty.

3.7 The process is not always well understood by borrowers and agents, leading to administrative failures where DTTP2 filings are overlooked, particularly following transfers or amendments during the life of a facility. There is often limited ability to negotiate changes to the risk allocation in the underlying loan in the case of such a transfer or to agree a new interest deferral post-transfer until the withholding position has been regularised.

Question 2 – Certainty of access to treaty relief

3.8 Please see our response to Question 1 above. Having the issue of the necessary treaty direction by HMRC as the sole determining factor provides a good level of certainty once obtained, but there is inherent uncertainty for the period between filing the DTTP2 and receiving the formal direction. Whilst HMRC's practice of allowing provisional clearance post-filing is helpful, it is not well understood by taxpayers and HMRC itself is not always clear in referring to the existence of this practice when acknowledging receipt of the DTTP2.

Question 3 – Self-assessment without prior HMRC clearance

3.9 Specific HMRC clearance for each transaction is unnecessarily bureaucratic and we consider that the current system can be simplified without risk of loss of tax. We support a move to self-assessment, but a balance needs to be struck to avoid the risks of such a change sitting solely with borrowers.

3.10 We note that extending self-assessment to treaty relief would be a logical extension of the self-assessed UK-to-UK exemption in section 930 Income Tax Act 2007. We understand that HMRC has been satisfied that the section 930 exemption has not given rise to the risks perceived when it was introduced, and we are not aware of any directions under section 931 ITA ever having been given. In our view, permitting borrowers to self-assess treaty entitlement — whilst retaining the existing clearance system as a means of obtaining certainty — would be a natural and proportionate development of the existing legislative framework.

Question 4 – Benefits of self-assessment

3.11 The Consultation proposes that the risk of incorrect self-assessment sits with the borrower, akin to the royalty withholding model.

3.12 In the large corporate loan market, this could be unsatisfactory and lead to costly lender/borrower negotiations that outweigh the perceived benefits of simplification, particularly in the case of syndicated facilities where non-bank lenders may participate.

3.13 In other lending markets, such as private credit lending, it may be difficult for a borrower to determine a lender's entitlement to treaty relief (see our comments at Question 5 below) to the degree of certainty that would be sufficient for that borrower to be prepared to pay interest without withholding solely on the basis of their self-assessment.

Question 5 – Satisfying treaty relief requirements; international experience

3.14 Determining treaty entitlement with certainty is difficult given overlapping legal questions (the principal purpose test, limitation on benefits, *Indofood* guidance and beneficial ownership). Borrowers generally lack sufficient visibility into their lenders' affairs and, if self-assessment were adopted, would need to rely on information provided by lenders.

3.15 One example of a self-assessment regime that we regularly deal with is Ireland. The system there operates primarily through simpler domestic exemptions; in circumstances where treaty entitlement operates as a fallback, this is satisfied by lender self-certification via a prescribed form, with a 90-day initial ability to rely on AML information if the form is not yet available.

3.16 We suggest that the following options could be considered alongside the introduction of a self-assessment regime, in order to provide borrowers with the necessary certainty:

(A) Retention of a modified treaty passport scheme, under which borrowers can pay without withholding to passported lenders unless notified that the passport has been withdrawn.

(B) Lender self-certification (modelled on US W-8 forms or the QPP regime), with borrowers able to pay without withholding unless notified otherwise.

(C) A clearance facility for non-standard situations (see Question 7).

3.17 An alternative, more radical, simplification measure would be the abolition of UK withholding tax on interest (potentially with some exclusions, e.g. where necessary to protect against profit shifting between related parties). This would align the UK with other jurisdictions where there is generally no withholding tax on interest (such as Luxembourg) or where a broad exemption from withholding exists that can be relied upon in many common lending situations (such as the US, where the portfolio interest exception allows many foreign lenders to receive interest income from US sources free of the standard 30% withholding on FDAP income).

Question 6 – Limiting self-assessment to low base-erosion-risk situations

3.18 Whilst we can see the rationale for a two-tier system under which streamlined processes are not available for loans giving rise to a risk of profit shifting, our preference is that there should be no additional tests or conditions for self-assessment to apply. In our view, the risk of base erosion is adequately addressed by the existing rules referred to in Question 6 of the Consultation (including transfer pricing, the corporate interest restriction and Pillar 2), and introducing further conditions specific to self-assessment would risk undermining the simplification that the Consultation is seeking to achieve.

3.19 To the extent that a threshold is nonetheless considered necessary, the application of other restrictions on deductibility (such as those listed in Question 6) is not the right starting point for this distinction, which in our view needs to be clear and easy to apply in practice.

Question 7 – Advance clearance facility

3.20 We see value in retaining a modified treaty passport register for regular lenders and a streamlined form DT Company process for occasional lenders, resulting in clearance along existing lines.

Question 8 – International examples of low-burden but effective regimes

3.21 The Irish system provides simplified domestic exemptions operating automatically, but disapplies the relaxation for related party borrowers where lenders are in specified non-cooperative or "zero-tax" jurisdictions.

3.22 Any such approach requires very careful definition of the related party concept, particularly given the frequent involvement of investment funds on both sides, to ensure that genuine commercial lending falls outside its scope.

Question 9 – Impact on tax receipts / avoidance / evasion

3.23 There is an opportunity to improve the UK's perception as a borrower jurisdiction; loans are frequently structured to avoid direct lending into the UK, and a genuinely simplified system could resolve this.

3.24 The proposed EU Tax Omnibus package further underscores the risk that retaining stringent processes makes the UK an outlier.

Questions 10 and 12

3.25 We are not in a position to comment on these questions.

Question 11 – Reporting requirements (CT61 vs CT600H)

3.26 In our experience (and whilst we don't generally deal with tax reporting matters), clients go to some lengths to avoid the form CT61 compliance burden (given the need for separate processes to facilitate quarterly reporting) and would have a strong preference to roll reporting into their annual filing process along the lines of the CT600H.

Question 13 – Sanctions for non-compliance

3.27 It is difficult to comment on sanctions before the shape of the revised regime is known.

3.28 Whichever approach is ultimately adopted, we do not consider that sanctions should apply to borrowers which have taken reasonable, and ideally prescribed, steps to comply.

Question 14 – Other options for simplification

3.29 The system for granting relief for lenders benefiting from sovereign immunity should be streamlined by bringing it in line with the approach determined for treaty clearance.

3.30 It is increasingly common for partnerships to lend, but the application of the treaty passport scheme to them is uncertain. Assuming a modified treaty passport scheme is maintained, this should include a clear position for transparent entities such as partnerships, including partnerships with partners in multiple treaty jurisdictions, enabling them to benefit from the scheme.

Question 15 – Other comments

3.31 The policy adopted following this Consultation must be aligned with the outcome of the review of the HMRC concession on late-claimed treaty relief, so that there is no gap in protection for taxpayers (e.g. if self-assessment is introduced prospectively but the concession is curtailed in the meantime, taxpayers could be left exposed for historic compliance failures which would not arise under the new regime).

3.32 We have also identified simplification of the QPP regime as a further area the Government should consider, including the current minimum placement threshold and the lack of clarity for partnerships and other transparent entities. As part of such simplification, the position of loans could more clearly be addressed in legislation, in addition to dealing with circumstances where only some lenders/bondholders holding a particular loan/bond want to make use of the QPP regime.

3.33 The procedure for claiming treaty protection from annual payment withholding tax is unclear and HMRC should consider resolving this by adopting a similar system to interest withholding.

3.34 We would also observe that the current legislative framework, under which every person "by or through whom" a payment is made is jointly and severally liable for the withholding, creates disproportionate cost and complexity. In practice, many payments pass through chains of intermediaries, not all of whom will be aware of or in a position to discharge this obligation. In our view, primary liability should rest with the borrower, with other persons in the payment chain having only a secondary liability, and ideally a statutory right of recovery against the borrower (although it would be helpful to maintain a pragmatic approach to this, for example in the case of securitisations, where a treaty direction may be issued to the servicer/legal title holder to make payments of UK source annual interest to a non-UK securitisation issuer). Addressing this point would be a significant further simplification and would bring the UK into line with how other jurisdictions approach withholding obligations.

Simmons & Simmons LLP
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