

EXPLANATORY MEMORANDUM TO
THE TAXATION OF SECURITISATION COMPANIES (AMENDMENT)
REGULATIONS 2018

2018 No. 143

1. Introduction

- 1.1 This explanatory memorandum has been prepared by HM Revenue and Customs (“HMRC”) on behalf of HM Treasury and is laid before the House of Commons by Command of Her Majesty.
- 1.2 This memorandum contains information for the Select Committee on Statutory Instruments.

2. Purpose of the instrument

- 2.1 This instrument relates to the taxation of securitisation companies.
- 2.2 It makes provision for specific areas of uncertainty over the appropriate tax treatment of securitisation companies by amending and updating the existing regulations to ensure that these companies are subject to an appropriate tax charge.
- 2.3 It will also rectify an existing condition that has become ineffective, due to a change of accounting standards.

3. Matters of special interest to Parliament

Matters of special interest to the Select Committee on Statutory Instruments

- 3.1 The Regulations have effect for periods of account starting on or after 1 January 2018 current when the Regulations are made, but do not apply to the amended meaning of ‘financial asset’ in relation to a capital market arrangement in existence on the date that these Regulations are made. Authority for this retrospective effect is provided by Section 625(3) of the Corporation Tax Act 2010.

Other matters of interest to the House of Commons

- 3.2 As this instrument is subject to negative resolution procedure and has not been prayed against, consideration as to whether there are other matters of interest to the House of Commons does not arise at this stage.

4. Legislative Context

- 4.1 These Regulations amend the Taxation of Securitisation Companies Regulations 2006 (S.I. 2006/3296). These introduced new tax rules with effect for accounting periods beginning on or after 1 January 2007 for securitisation companies involved in the securitisation of financial assets. Such companies are taxed on their “retained profit” (the profit retained from their participation in the transaction) rather than the profit or loss shown in their statutory accounts.
- 4.2 These Regulations make provision in four specific areas of uncertainty relating to the tax treatment of securitisation companies, will rectify an existing condition that has become ineffective and update the existing statutory references.

5. Extent and Territorial Application

- 5.1 The extent of this instrument is the United Kingdom.
- 5.2 The territorial application of this instrument is the United Kingdom.

6. European Convention on Human Rights

- 6.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

What is being done and why

- 7.1 Securitisation is a widespread method of raising debt finance on the capital markets through the issue of asset-backed securities. Securitisation companies are special purpose vehicles which issue securities to third party investors which are backed by assets transferred by another company.
- 7.2 A securitisation company typically acts as a conduit in which income flows from the securitised assets are channelled to the investor in the form of interest on the securities. It will normally only retain a small cash profit over the life of the securitisation. The application of International Accounting Standards in 2005 led to increased volatility in the accounting profits of such companies. As a result the statutory accounts no longer formed a suitable basis for calculating a securitisation company's tax liability.
- 7.3 To enable the securitisation market to function, special corporation tax rules were required. In 2006 the "permanent regime" was introduced for companies involved in the securitisation of financial assets. These rules are now falling behind recent accounting and commercial developments and require updating in order to maintain the competitiveness of the UK financial services sector.
- 7.4 There can be uncertainty as to whether certain payments made on, or behalf of, securitisation companies known as residual payments constitute 'annual payments' for tax purposes and therefore whether they should be subject to withholding tax. Currently this uncertainty is addressed by writing to HMRC to seek clearance that residual payments will not be annual payments and so can be paid without withholding tax. This uncertainty will be eliminated by removing the obligation to withhold income tax in respect of such payments.
- 7.5 The corporation tax rules for securitisation companies apply to the securitisation of "financial assets". This category, which is based on the accounting treatment, excludes shares and land. From 1 January 2015, new accounting standards changed the treatment of certain instruments that include an embedded derivative, so that the current exclusion is no longer effective. A new definition of financial assets will maintain the policy intention that loans with embedded derivatives over shares or land are excluded from the regime.
- 7.6 In addition, the current definition of financial asset causes uncertainty which makes UK securitisation companies less commercially attractive. This uncertainty occurs where a securitisation company acquires a portfolio which might include non-financial assets. The revised definition will disregard small and insignificant non-financial assets where, despite reasonable care, they have been inadvertently included

in a portfolio otherwise consisting of qualifying financial assets. This will prevent them from tainting an entire securitisation transaction.

- 7.7 There can be uncertainty as to whether a securitisation company falls within the scope of legislation introduced to counter schemes which exploited the rules on company purchases. That legislation could result in a securitisation company becoming liable for unpaid corporation tax of other linked companies. The possibility of such legislation applying in practice is remote in practice but needs to be considered in every proposed securitisation transaction. This uncertainty will be eliminated by explicitly excluding securitisation companies from the scope of the legislation.
- 7.8 A warehouse company holds the financial assets to be securitised until the portfolio is large enough and market conditions allow the transaction to take place. There are tax rules governing a warehouse company's holding in notes issued to the investors or the asset portfolio. Minor modifications are required to align these with regulatory requirements. This will also facilitate certain types of commercial arrangements by which the portfolio is transferred out of the warehouse company to enable the securitisation transaction to take place.
- 7.9 Securitisation companies that fall within the "interim regime" are not affected by these changes. This regime enables a securitisation company that existed at 31 December 2004 and which meets certain conditions to ignore International Accounting Standards in computing its corporation tax liabilities.

Consolidation

- 7.10 There are no plans to consolidate this instrument.

8. Consultation outcome

- 8.1 HMRC has been working with the securitisation industry consultative group since October 2015. This group was formed to consider ways of updating the corporation tax treatment of securitisation companies to take account of changes to accounting standards and commercial developments since the regime was introduced. Discussions with the consultative group and other professional firms have confirmed that these areas can cause uncertainty of tax treatment for businesses wishing to raise finance using a UK securitisation company and would benefit from additional clarification. There is no policy change.
- 8.2 A consultation ran for six weeks, ending on 15 January 2018, with draft Regulations and a draft Explanatory Note published on www.gov.uk. No responses were received. The Regulations are unchanged following consultation, apart from minor amendments.

9. Guidance

- 9.1 Updated guidance will be available when the changes have been brought into force and will be incorporated into HMRC's Corporate Finance manual in due course.

10. Impact

- 10.1 The impact on business, charities or voluntary bodies is negligible.
- 10.2 There is no impact on the public sector.
- 10.3 A Tax Information and Impact Note covering this instrument was published on

4 December 2017 alongside the consultation draft of the Taxation of Securitisation Companies (Amendment) Regulations 2018 and is available on the website at <https://www.gov.uk/government/collections/tax-information-and-impact-notes-tiins>. It remains an accurate summary of the impacts that apply to this instrument.

11. Regulating small business

11.1 The legislation does not apply to activities that are undertaken by small businesses.

12. Monitoring & review

12.1 Corporation tax work on securitisation companies is handled by HMRC's securitisation companies unit. HMRC will monitor the changes to the existing regime through communication with affected securitisation companies and their professional representatives.

13. Contact

13.1 Elizabeth Ward-Penny at HM Revenue and Customs Telephone: 03000 585876 or email: elizabeth.ward-penny@hmrc.gsi.gov.uk can answer any queries regarding the instrument.