UK TAXATION OF SECURITISATION COMPANIES – A REGIME IN NEED OF REFORM?

The special rules ('**securitisation regime'**) under which a cashflow (rather than accounts) basis of taxation applies to the retained profit of a securitisation company were introduced in 2006. Changes made to the regime over the intervening fifteen years have been relatively incremental. However, on 23 March 2021, HM Treasury and HM Revenue and Customs (**HMRC**) fired the starting gun on a consultation that will run until 3 June 2021.

This consultation, the outcome of which is expected to be revenue neutral for the Exchequer, raises the possibility of reform in four separate areas which we have summarised below in order of what we anticipate ought to be their commercial significance:

'Retained securitisations'

One of the requirements for the securitisation regime to apply is that securities issued by a securitisation company (known as a 'note issuing company') must be issued 'wholly or mainly' to 'independent persons' unconnected with the note-issuing company.

HMRC has published guidance on the application of this test, but the rigidity and uncertainty associated with that guidance can be illustrated by HMRC's view that a compliant intermediary can only acquire securities if that intermediary has 'no freedom' to retain the securities or acts as an underwriter in the ordinary course of its business.

There are circumstances in which an originator may wish, for commercial reasons, to retain 50% (or more than 50%) of securities issued by a note-issuing company. Such circumstances include where market conditions make it desirable for an originator to retain notes until a period of market turbulence has passed. Furthermore, in the wake of the Covid-19 crisis, originators have sought to use securities as eligible collateral for funding schemes overseen by the Bank of England and financial institutions conducting treasury operations have sought to access alternative funding sources (such as the repo markets) using securities issued by a connected note-issuing company.

The government is open to reform which could enable the securitisation regime to better serve the market needs in relation to retained securitisations and, thereby, assist international competitiveness of the UK as a financial services centre.

Stamp duty and stamp duty reserve tax

The government has acknowledged that doubts as to the scope of provisions which can prevent the loan capital exemption from stamp duty and SDRT applying can discourage the use of the securitisation regime (or the separate regime for insurance linked securities), or can cause somewhat expensive and convoluted arrangements to be put in place so that reliance is not placed on the loan capital exemption.

Another area of difficulty identified by the government can arise in relation to the need to carry out due diligence on loans issued by SMEs to confirm suitability for pooling, which can be sufficiently burdensome to render the securitisation of such loans uneconomic.

One of the possibilities that the Government is considering is whether updated HMRC guidance could be helpful. One difficulty with such an approach is that the loan capital exemption adopts language also used elsewhere in the UK tax code and the scope for guidance which would not cause unintended consequences elsewhere may be limited. No mention is made of a 'call for evidence' that ran between July and October 2020 into a wholesale reform of UK stamp duty and SDRT[1].

'Financial assets'

The consultation explores whether the definition of 'financial assets', which can be held within the securitisation regime, should be extended to include shares in limited circumstances, such as where shares are issued as the result of a restructuring or bailout of an existing securitisation.

The possibility of including land is also alluded to, but it is made clear that including land is for this consultation exercise. The possible inclusion of land, it appears, is a rather more long term project – rather than a pot which is likely to come to the boil in the near future.

£10 million minimum threshold

The government has recognised that the requirement for a note-issuance company to issue securities with a. value of at least £10 million, can prevent charities accessing the securitisation regime. The £10 million threshold can also hinder 'recycling' a note-issuance company (e.g. because an issue that is not within what HMRC regards as a 'reasonable period' – usually 20 days - is treated as a separate issue) and, if that subsequent issue is not of at least £10 million a note-issuance company will be disqualified from the securitisation regime).

Any lowering of the £10 million threshold may, to prevent the securitisation regime applying accidentally, involve the introduction of a requirement to 'elect-in' to the regime.

Conclusion

As a potential reform package, the consultation holds out the prospect of some helpful changes. What is missing, perhaps, is clarity and a wider vision as to how these proposals sit in the context of more wide-ranging reform of UK stamp duty/SDRT and the possible introduction of a new asset holding company regime.

[1] HMRC, Modernisation of the Stamp Taxes on Shares Framework (21 July 2020).

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