



**Weil**

Tax in Distressed Situations  
**UNITED KINGDOM**

## GENERAL

### 1. Does debt have a specific meaning for tax purposes?

For UK corporation tax purposes, the general position is that a company has a loan relationship if it stands in the position as creditor or debtor as respects any money debt and that debt arises from a transaction for the lending of money. Therefore there are two critical aspects:

- there must be a money debt (being a debt which may fall to be settled by payment of money, issue or transfer of shares, or other debt which itself is a money debt); and
- the money debt must arise out of a loan.

Of course, not all money debts will arise out of the lending of money (for instance, loan notes issued as part of the consideration mechanic on a share acquisition, or intercompany recharges). For this reason, a money debt is treated as arising from a transaction for the lending of money if an instrument is issued unilaterally for the purposes of representing security for the debt or the rights of the creditor in respect of the debt.

Where there is any doubt as to the nature of the debt and the taxpayer wants certainty that the debt should be treated as a loan relationship for UK corporation tax purposes, the debt can be “papered” by the debtor unilaterally issuing an instrument to the creditor.

In addition to the above, there are further rules which apply to treat certain other money debts as loan relationships for UK corporation tax purposes including:

- money debts that do not arise from a loan (and are not deemed to have so arisen – see above) but on which, amongst others, (i) interest accrues, (ii) exchange gains / losses arise, or (iii) a deduction is allowable in calculating the profits of a trade or property business;
- arrangements which produce an interest-like return; and
- investments in certain investment funds and mutual societies.

As can be seen, the definition of a “loan relationship” is very broad for UK corporation tax purposes. Unless specified otherwise, the remainder of this commentary assumes that the debt is treated as a loan relationship for UK corporation tax purposes.

### 2. Do derivatives have a specific meaning for tax purposes?

The taxation of derivative contracts is highly complex. However, for UK corporation tax purposes, a contract of a company is a derivative contract of the company for an accounting period if three conditions are met:

- the contract is an option, a future or contract for difference (each of which have their own definitions in the UK tax code albeit those definitions are broad and the intention is that most derivative contracts (in the non-tax sense) will fall within one of those definitions);
- the contract:
  - is treated as a derivative contract for accounting purposes;
  - is not treated as a derivative contract for accounting purposes because of not meeting the requirement of paragraph 9(b) of Financial Reporting Standard 26 (issued in December 2004 by the Accounting Standards Board) but is, or forms part of, a financial asset or liability for accounting purposes; or
  - has commodities as an underlying subject matter or is a contract for difference with certain prescribed subject matter; and
  - the contract is not excluded from being treated as a derivative contract under the UK tax code.

### 3. Generally, are intra-group debts treated differently to external debt for tax purposes?

The definition of a loan relationship for UK corporation tax purposes as set out above applies equally to intra-group debt as well as external debt. However, as further set out below, the UK corporation tax treatment of intra-group debts can differ to the treatment of external debt where the creditor and debtor are treated as “connected companies”.

For these purposes, there will be a connection between one company and another for an accounting period if there is a time in the accounting period where one company controls the other or they are both controlled by the same person. For these purposes control, in relation to a company, means the power of a person to secure that the affairs of the company are conducted in accordance with that person's wishes by means of holding shares or voting power, or as a result of any powers conferred by the articles of association or other document regulating the company.

There are certain rules which override the general position and ignore the connection between companies including, in certain government and other public and international ownership scenario, or where the creditor is a financial trader or life insurance company.

Where companies are connected for UK corporation tax purposes, generally the parties will need to account for the loan relationship on an amortised cost basis and, as set out below, any rationalisation of debt may be treated differently to the rationalisation of external (non-connected) debt.

In addition, certain rules (such as the transfer pricing or anti-hybrid rules) may be in point in a connected party scenario.

#### **4. Does it make a difference if debt is owed by a partnership or other pass through entity in distress to third parties versus to its partners?**

There are specific rules applicable where a trade or business is carried on by a partnership where one or more of the partners is a company and a money debt is owed by or to the partnership.

Generally, in that scenario, no credits or debits are to be taken into account in calculating the profits or losses of the partnership. Instead, each corporate partner in the partnership must bring into account its applicable share (in accordance with the partnership's profit sharing arrangements) of any credits and debits arising in respect of the money debt owed to or by the partnership.

The "connected company" rules summarised above may also be in point where a corporate partner, either alone or together with other corporate partners, controls the partnership.

## **DEBT IMPAIRMENT**

### **1. What are the key tax considerations on a debt impairment for the creditor?**

Upon impairing a debt which constitutes a loan relationship for UK corporation tax purposes, generally a UK creditor should be able to claim a debit for UK corporation tax purposes to the extent of that impairment.

However, the general position is overridden where there is a "connection" between the creditor and debtor at any point in the accounting period (with the result that no debit would be allowable for UK corporation tax purposes in respect of the impairment) unless:

- the creditor and debtor become connected as part of a debt-for-equity swap whereby the creditor treats the debt as discharged in consideration for the issue of ordinary shares by the debtor; or
- the creditor is in insolvent liquidation, administration or receivership and the debit arises during the course of the liquidation, administration or receivership of the creditor.

### **2. What are the key tax considerations on a debt impairment for the debtor?**

The impairment of debt by the creditor should have no adverse UK tax consequences for a debtor.

## **DEBT AMENDMENT, REFINANCING AND NOVATION**

### **1. What are the key tax considerations on a debt amendment?**

Where an amendment to an existing debt (including agreements to subordinate or enter into a moratorium) gives rise to accounting adjustments, this can result in taxable credits for the debtor company unless, without that amendment, there would be a material risk that the company would be unable to pay its debts in the subsequent 12 months (see below "Does the release of debt trigger taxable income for the debtor? If so are there any reliefs or exemptions?").

In addition, debtors will need to consider whether the amendment impacts the deductibility of interest accruals arising in respect of the amended debt, taking into account the various UK tax rules that can limit interest deductibility.

## **2. Does the deferral of any payments of interest or repayments of principal trigger tax consequences?**

For UK corporation tax purposes, interest income and expenses are generally accounted on an accruals (rather than cash paid) basis. Therefore, the deferral of any interest accrual may impact on the timing of recognition of any interest income and expense.

Unless the deferral has the effect of giving rise to accounting adjustments (see above), the deferral of any repayment of principal should not trigger adverse UK corporation tax consequences for the debtor.

Assuming the debt was not discounted and has not been impaired by the creditor, repayment of principal should not give rise to any adverse UK tax consequences for a UK debtor or creditor. Where a debt was issued at a discount or has been impaired by the creditor, any repayment of principal which exceeds the impaired amount of debt recorded in the accounts of the creditor or which constitutes repayment of the discount element, would be taxable in the hands of the creditor.

## **3. What are the key tax considerations on a debt refinancing?**

A debt refinancing, whether in a distressed scenario or otherwise, generally has the same key UK tax considerations:

- **Withholding tax.** In principle interest payments by UK debtor companies to non-UK creditors will be subject to UK withholding tax unless treaty relief is available or a domestic exemption (for example the “qualifying private placement” or “quoted Eurobond” exemption) applies. Of particular relevance in a distressed scenario, is the fact that a “payment-in-kind” does not obviate the UK withholding risk; the UK withholding regime applies equally to cash or interest satisfied through the issuance of shares or further debt (see below “Does rolling up interest or satisfying interest through issuing “payment in kind” notes give rise to any tax consequences?”). Further, in distressed scenarios it is not uncommon for any new debt to be issued at a discount or with a premium. In the case of discounted debt, any payment of the discount element of the redemption amount should not give rise to any UK withholding liability (on the basis that the discount should not be treated as interest for UK withholding purposes). The position is more complex with respect to the UK withholding position on payments of premium and would depend on an application of established case-law principles to all the facts and circumstances.
- **Interest deductibility.** As set out above, interest is generally a deductible expense for UK corporation tax purposes on an accruals basis. However, there are a number of detailed rules which can apply to restrict deductibility of interest for UK tax purposes which will need to be considered as part of the debt refinancing. In a distressed scenario where discounted debt or debt carrying a premium is issued, there is an increased risk that any interest (which for UK corporation tax purposes would include the discount and premium) might exceed a reasonable commercial rate of interest would be recharacterised as a non-deductible distribution for UK tax purposes. In addition, given the nature of the discount / premium, there may be an impact on the timing of the recognition of interest expense for UK corporation tax purposes (it may be deferred to payment rather than deductible on an accruals basis under certain anti-avoidance provisions).
- **Stamp duty.** Although there is no stamp duty on the issue of debt, it will be important to consider the stamp duty position on any transfer of debt. Whilst most “plain vanilla” debt should be exempt from stamp duty (either on the basis of being a non-marketable debenture or meeting the conditions of the loan capital exemption), where debt carries non-vanilla features (for instance, conversion into equity, or excessive interest) this can result in the non-availability of stamp duty exemptions typically relied on when transferring debt.

## **4. Does rolling up interest or satisfying interest through issuing “payment in kind” notes give rise to any tax consequences?**

For UK corporation tax purposes, interest income and expenses are accounted generally on an accruals (rather than cash paid) basis. Accordingly, neither the rolling of interest nor issuance

of payment-in-kind (“PIK”) notes themselves should have any adverse UK corporation tax consequences for either a UK creditor or a UK debtor.

However, for UK withholding tax purposes there is an important distinction between a roll-up and satisfaction of interest through issue of PIK notes.

- Roll-up of interest. Rolling up (or capitalisation) of interest should not be regarded as a payment for UK withholding tax purposes with the result that no UK withholding should be triggered on the roll-up. If and when the rolled-up interest is paid, the debtor would then need to consider whether any UK withholding is due on the payment as the rolled-up interest, even if capitalised and added to principal outstanding, does not lose its character as interest for UK withholding tax purposes when it is actually paid.
- Satisfaction of interest through PIK notes. The issuance of PIK notes in satisfaction of interest is treated as a payment for UK withholding purposes and treated in the same way as if there had been a cash settlement of the interest. Accordingly, in this scenario, a debtor would need to consider whether it is under any obligation to withhold and account to the UK tax authority. If the UK debtor is so required to withhold, technically, the UK debtor is required to withhold 20% of the PIK notes and account for those to HMRC; in practice, HMRC accept cash settlement of any UK withholding liability.

#### **5. Does the novation of debt by a debtor to another group company trigger any adverse tax consequences?**

Generally the intra-group novation of debt between UK tax resident entities should be tax neutral for UK corporation tax purposes on the basis of the so-called “group continuity” rule which treats the novation as being effected for consideration equal to the notional carrying value of the debt. HMRC take the view that, for the tax neutrality rule to apply, there must be a novation of the entire debt (and for this reason, where only some of the debt will be novated, debts are sometimes “re-tranched” prior to a novation).

Upon the novation of debt, the original debtor will ordinarily owe the new debtor an amount equal to the debt assumed by the new debtor. Generally, this will take the form of a new intercompany balance between the two entities. With respect to the new intercompany balance, the general points to consider in respect of intercompany debt would be equally applicable here including, for instance, whether:

- the debt is a loan relationship for UK corporation tax purposes and whether the debt should be “papered” (see above “Does debt have a specific meaning for tax purposes?”);
- if the debt is interest bearing, if any UK withholding tax arises on payments of interest;
- if the debt is non-interest bearing, if an arm’s length interest rate is imputed under transfer pricing principles; and
- any interest accrual (whether actual or imputed arm’s length rate) is deductible or taxable for UK corporation tax purposes.

#### **6. Are there any specific tax considerations to bear in mind where the security / guarantee package is amended as part of the debt amendment / refinancing?**

No adverse UK tax consequences should arise on entry into a guarantee by a UK guarantor or on the taking of security over a UK-based asset, although debtors should be conscious as to whether the support affects the deductibility of debt under transfer pricing provisions.

Where a guarantee is provided by a UK guarantor, applying transfer pricing principles, it should be determined whether the UK guarantor should be remunerated for having provided that guarantee for the benefit of the borrower.

## **DEBT RELEASES**

#### **1. Does the release of debt trigger taxable income for the debtor? If so are there any reliefs or exemptions?**

The starting point is that the release of a debt will generally give rise to an accounting credit and so taxable income for a UK debtor. However, there are a number of statutory exemptions in the UK tax code that override that general position.

Where the debt is between "connected" companies for UK tax purposes (see above) releases should not give rise to taxable income for a UK debtor.

Where the debt is not between connected companies for UK tax purposes releases should not give rise to taxable income for a UK debtor where:

- the release is part of a statutory insolvency arrangement being (i) a voluntary arrangement under applicable UK insolvency law, (ii) a compromise or arrangement under Part 26 or Part 26A of the UK Companies Act 2006, or (iii) an arrangement or compromise of a kind corresponding to those in (i) or (ii) under the law of a territory outside of the UK;
- the release is in consideration for the issue for shares i.e. a debt-for-equity exchange (see section below "Debt for equity exchange");
- the debtor is in insolvent liquidation, administration, receivership or an appointment of a provisional liquidator is in force under applicable UK insolvency rules, or under the law of a territory outside of the UK where the debtor is undergoing equivalent proceedings;
- the liability is released in consequence of the making of a mandatory reduction instrument or third country instrument or the exercise of a stabilisation power under Part 1 of the Banking Act 2009; or
- immediately prior to release it is reasonable to assume that, without the release (and arrangements of which it forms part), there would be a material risk that at some point within the next 12 months the company would be unable to pay its debts. HMRC take this to mean that, based on all of the evidence available, there must be a realistic likelihood of the company going into insolvency if remedial action is not taken. In other words, there must be more than a possibility of insolvency or a temporary issue.

Where no exemption is available consideration should be given to whether any losses are available to shelter any UK tax leakage arising on the debt release.

**2. Does the release of debt trigger any withholding or indirect tax? If so are there any reliefs or exemptions?**

Provided the debt is truly released (rather than e.g. satisfied through the issuance of shares), a debt release should not give rise to any UK withholding or indirect tax exposure.

**3. Can a creditor claim a deduction in respect of any debt that is released?**

The same principles set out above in "What are the key tax considerations on a debt impairment for the creditor?" equally apply.

**4. Is the position different if the debt being released is a trade debt?**

As set out above (see "Does debt have a specific meaning for tax purposes?") most trade debts will be regarded as "loan relationships" for UK corporation tax purposes with the result that the position set out above would equally apply to trade debts.

In practice, a point of distinction may arise where the trade debt cannot be treated as a loan relationship because it is not a "money debt". An example of this could be where the debt is not capable of being settled by the payment of money, for instance, if the debt needs to be settled "in kind".

In this scenario, under general principles, if a deduction has been allowed in calculating trading profits in respect of that debt and the debt is released other than as part of a statutory insolvency arrangement (see above "Does the release of debt trigger taxable income for the debtor? If so are there any reliefs or exemptions?") any deduction previously claimed is reversed.

**5. Does the release of an uncalled guarantee obligation trigger any adverse tax consequences? Is the position different if the guarantee has been called?**

Assuming it is not recognised as a liability for accounting purposes, the release of an uncalled guarantee obligation (being a contingent contractual promise) should not have any adverse UK tax consequences.

Conversely, where the borrower has defaulted and the guarantee called, the position is more complex. Where the guarantee has been called the obligation to make the payment under the guarantee would have crystallised and so, for accounting purposes, may be treated as a current

liability. Although fact dependent and subject to the accounting treatment in the circumstances, HMRC's view is that once called the guarantee would likely be a deemed loan relationship for UK corporation tax purposes with resulting UK corporation tax implications on any subsequent release.

**6. Do any adverse tax consequences arise on the release of liabilities owed under a derivative contract?**

The starting point is that the release of liabilities owed under a derivative contract will generally give rise to an accounting credit and so taxable income for a UK debtor unless it is released as part of a statutory insolvency arrangement (see above "Does the release of debt trigger taxable income for the debtor? If so are there any reliefs or exemptions?"). It may also be possible to "paper" the derivative liability through the issue of a unilateral instrument by the debtor such that the liability is treated as a loan relationship for UK corporation tax purposes.

## DEBT FOR EQUITY EXCHANGE

**1. What are the key tax considerations on a debt-for-equity exchange for the creditor?**

Generally, where the creditor is not connected to the debtor, the UK creditor should be able to claim relief on the debt-for-equity exchange for UK corporation tax purposes to the extent of the difference between the carrying value of the loan relationship and its market value on the date of the exchange. Such relief is not available where the creditor is connected to the debtor prior to the exchange. The creditor's tax basis in the shares issued as part of the exchange should equal the market value of the debt immediately prior to the exchange.

**2. What are the key tax considerations on a debt-for-equity exchange for the debtor?**

Generally, a debtor is not required to recognise any taxable income in respect of the release of debt where the release is in consideration for the debtor issuing ordinary share capital (or an entitlement to such shares) to the creditor. There are a few specific points to note with this exemption:

- The shares issued must be ordinary share capital. However, where there is a lag between debt release and share issue HMRC will accept that the exemption may continue to apply provided the company is under a binding obligation to issue the shares. HMRC has also confirmed its view that the exemption also applies where the creditor is issued with an option or warrant entitling it to subscribe for shares at a future date, provided there is a genuine commercial expectation that the option or warrant will be exercised.
- In distressed scenarios, the value of the shares issued may be worth considerably less than the amount of debt released. HMRC's position is that it will not argue that this exemption will not apply just because there is a wide disparity between the nominal amount of the debt released and the market value of the shares that are issued.
- The debt needs to have been released in consideration for the issue of the shares. There is no requirement for the shares issued by the debtor company to be held for any particular length of time (in some cases, a creditor may need to transfer the shares received immediately on receipt as a result of regulatory constraints). However, taking a realistic view of the transaction, there may be a question whether the release is really "in consideration" for shares where there are arrangements (contractual or otherwise) in place at the time of the debt-for-equity exchange for the creditor to divest immediately to a company connected with the borrower.

In practice, where a debt-for-equity exchange is proposed the debt may not be in the "right" place in the group structure and so an internal group reorganisation may be required. Generally such reorganisations should be able to be implemented on a tax neutral basis.

Where a debt-for-equity exchange is proposed, to mitigate any UK withholding risk arising on any payment of accrued interest on the debt, the exchange could be effected as a release in consideration for the issue of shares as opposed to a satisfaction of the debt through issuance of shares.

A debt-for-equity exchange may result in a change of control of the debtor as to which see below "Are there any adverse tax consequences arising from a change of control or break of a tax group?".

Finally, a debt-for-equity exchange may impact on the debtor's interest capacity under the UK corporate interest restriction, see Weil Tax Blog "[The UK Corporate Interest Restriction and the Debt Restructuring Exemption](#)".

**3. Where warrants or similar instruments are issued as part of a debt restructuring does this trigger any adverse tax consequences?**

**WARRANTS**

The issue of warrants (or similar option-like instruments) as part of a debt restructuring may trigger adverse UK tax implications for a UK issuer. Subject to the accounting treatment, for UK corporation tax purposes:

- where an option is granted by a UK grantor that grantor is treated as having disposed of an asset;
- as the grantor is unlikely to have tax basis in the asset being disposed of, a chargeable gain may arise on either the consideration paid for the grant or, in some cases, the market value of the option; and
- if the option is subsequently exercised, the UK tax charge arising on grant should be unwound.

The extent of any UK tax charge depends on the precise facts. Further the mechanic for unwinding any such charge on exercise is not always obvious, including where exercise occurs more than two years after the end of the accounting period in which the option was granted. For further information see Weil Tax Blog "[UK tax on granting options: when is an option not an option?](#)"

In the event that the warrant is treated as a derivative contract for UK corporation tax purposes, the UK tax treatment described above does not apply and, instead, the warrant is treated as a derivative for UK corporation tax purpose and taxed accordingly.

Finally, the UK stamp duty position on both the issue and exercise of warrants is complex but, depending on the facts, generally the issue of a warrant in a distressed scenario would not be expected to trigger adverse UK stamp costs.

**CONTINGENT VALUE RIGHTS**

As part of a debt restructuring, "contingent value rights" may be issued to shareholders / creditors in the distressed company. The form of such rights will vary depending on the commercial terms but, assuming such rights are accounted as equity instruments for accounting purposes, generally speaking:

- no adverse UK tax consequences should arise on the issue of the rights;
- the rights should not be treated as an option for UK tax purposes (see above);
- payments on such rights should be treated by the payer as a non-deductible distribution for UK corporation tax purposes and not subject to UK withholding tax.

**4. What are the key tax consequences of capital contributions by a parent company into its subsidiary?**

Where a parent company wishes to support a distressed subsidiary by way of capital contribution, from a UK corporation tax perspective such contribution should take the form of a share subscription. Effecting the contribution as a share subscription has two benefits:

- the contribution should increase the parent's tax basis in the subsidiary (albeit this may be capped at the market value of the shares issued); and
- it provides certainty of treatment on receipt for the subsidiary by ensuring that the amount received should not be taxable for UK corporation tax purposes.



## FEES AND TRANSACTION COSTS

### 1. Is there any adverse tax impact in respect of common restructuring fees, for example, consent fees?

Provided that any fee is paid solely for the purposes of agreeing to or securing a restructuring of debt or equity, such fee should generally be treated as an exempt supply for UK VAT purposes. Payment of such a fee should not give rise to any UK withholding tax.

### 2. Are transaction costs deductible for tax purposes and is any VAT recoverable?

Generally, transactions costs will be deductible for corporation tax purposes where they are revenue in nature and incurred "wholly and exclusively" for the purposes of a trade (where the company carries on a trade) or constitutes "expenses of management" (where the company carries on an investment business).

However, this general position is overridden by the UK loan relationship code which provides that profits and losses on a so-called "related transaction" need to be brought into account. For these purposes a "related transaction" means "any disposal or acquisition (in whole or in part) of rights or liabilities under the loan relationship, including where rights are transferred or extinguished by any sale, gift, exchange, surrender, redemption or release."

Therefore, generally under the UK loan relationship rules, costs arising to a company directly from entering into, or giving effect to, a "related transaction" should be deductible for UK corporation tax purposes.

The recoverability of VAT follows the general position and looks to whether the incurrance of the cost has a direct and immediate link with the taxable person's supplies or business. To the extent that there is such a link, the VAT recoverability will turn on the general VAT recoverability profile of the taxable person concerned.

As a general rule, typically on a debt restructuring a UK debtor may be able to recover VAT it incurs in connection with its own costs and expenses but, depending on the facts, may struggle to recover VAT on fees on creditors' advisors which the borrower settles.

## DEBT ENFORCEMENT

### 1. Aside from insolvency proceedings, what are the key methods of enforcement and their tax impact?

The key methods of enforcement by a creditor include exercising a power of sale and foreclosure. In addition, a creditor may agree that a distressed borrower may transfer the secured assets to the creditor in discharge of the debt. It is only these three methods of enforcement which are considered in this section.

Other methods such as the appointment of a liquidator, administrator, or receiver are addressed in the "Insolvency Proceedings" section.

### 2. If the enforcement results in the creditor taking ownership of equity or assets, what are the key tax considerations to bear in mind?

It is not always the case that a creditor will take ownership of equity or assets upon an enforcement. For instance, where a creditor exercises a right of sale, the creditor will direct the debtor to transfer the secured asset to a third-party acquirer with the proceeds of sale to be held on trust by the creditor and used to discharge the debtor's liabilities. In this scenario, the lender is acting as nominee for the debtor with the debtor treated as having made a disposal of the asset for UK corporation tax purposes for consideration equal to the amount realised on sale (resulting in a gain or loss).

However, where the creditor takes possession of the asset (for instance, by way of foreclosure or the debtor transferring secured assets in satisfaction of debt) the following summarises the key tax considerations:

- UK corporation tax. For these purposes the consideration for the disposal is the amount of debt satisfied or released by the transfer (capped at the market value of the asset transferred) resulting in a gain or loss for the debtor and that amount forming the UK tax basis for the creditor.

- UK stamp duty. The position is similar to the UK corporation tax position: the consideration for the disposal is the value of debt satisfied or released by the transfer (capped at the market value of the asset transferred)

However, it may be the case that instead of an asset being transferred in satisfaction of a debt the creditor agrees to acquire an asset of the debtor which is set-off against the debt due by the debtor to the creditor. In this scenario, the amount agreed between the parties would generally be regarded as the consideration for both UK corporation tax and stamp duty purposes.

Finally, in each case, where there is a change of control (or a break of a tax group) this can give rise to adverse tax consequences (see “Are there any adverse tax consequences arising from a change of control or break of a tax group?”)

### 3. Are any specific tax considerations arising on payments or transferring security under guarantees as opposed to the debt?

The UK tax treatment of payments under guarantees is complex. Below is a high-level summary of the UK tax treatment but for more detail on the UK tax considerations on guarantees see “[Guarantees Revisited](#)” produced by the Weil UK tax team:

- UK corporation tax. For the guarantor the tax treatment of a cash payment upon default is complex. HMRC’s view is that there is no loan relationship and, even though the guarantee may be treated as a loan relationship after being called, amounts payable are not interest payments. On that view, no deduction is available to the guarantor on payments made under the guarantee under the UK loan relationship rules. Equally, applying general principles, a payment under a guarantee will likely be treated as a capital payment for which the guarantor will be unable to claim a deduction (and, in any event, it is unlikely that the payment would have been made by the guarantor wholly and exclusively for the purposes of its trade). However, if possible, under specific provisions of the UK tax code, a guarantor may look for relief on payments made but this is not straightforward.
- UK withholding tax. There are a few different possible analyses:
  - Where the guarantee payment assumes the nature of the debt obligation, UK withholding tax would be due if the guaranteed payment is in respect of annual interest and paid from a UK source. This may also allow the guarantor to benefit from any exemption applicable to the underlying obligation. However, the difficulty with this approach is that it is not the analysis that HMRC applies to guarantee arrangements generally.
  - Where the guarantee is regarded as a separate obligation, the guarantor should only be required to withhold UK tax to the extent that the payment is treated as an “annual payment” for UK tax purposes (on this view the payments should not be “interest” for UK withholding purposes).
  - It may be possible to avoid any uncertain withholding tax analysis through the guarantor putting the borrower in funds, rather than making guarantee payments itself.
  - If a guarantor does make payments and a UK withholding tax obligation arises in relation to which no domestic exemption applies, it may be possible to mitigate UK withholding tax leakage through a claim under a double tax treaty. This may be through the “interest” article (noting here that “interest” in a treaty may have a wider meaning than under UK domestic law) or under the “other income” article. The procedures to enable a payer company to pay without deduction may be different depending on the characterisation of the payment.

With respect to the release of guarantees see above “Does the release of an uncalled guarantee obligation trigger any adverse tax consequences? Is the position different if the guarantee has been called?”

With respect to UK tax issues arising on the transfer of security see above “If the enforcement results in the creditor taking ownership of equity or assets, what are the key tax considerations to bear in mind?”

#### 4. Are there any adverse tax consequences arising from a change of control or break of a tax group?

The principal UK tax implications resulting from a change of control or break of a tax group are as follows:

- Losses.
  - Carried forward trading losses may be restricted upon a change of control if there is a major change in the nature or conduct of the trade within a period which (subject to certain exceptions) is five years starting no more than three years before and ending five years after a change of control.
  - Carried forward non-trading losses may be restricted upon a change of control if there is (i) a major change in the nature or conduct of the business within a period of eight years starting three years before the change of control, or (ii) a significant increase in capital. In each case, there may also be restrictions where the company's activities have become small or negligible and there is a significant revival in the trade/business post change of control.
- Degrouping event. A change of control may well break a group for UK tax purposes which may have the effect of (i) eliminating the ability to make tax neutral asset transfers or surrender losses by way of group relief, and (ii) triggering a clawback of any relief previously claimed on intra-group asset transfers. Note, a transfer of shares is not required; such degrouping events may arise on entry into insolvency proceedings (see below "Insolvency Proceedings").
- Deemed release. A so-called "deemed" debt release may arise in respect of any impaired portion of debt where an unconnected creditor and debtor are party to an impaired debt and subsequently become connected unless the "corporate rescue" exemption applies. The "corporate rescue" exemption applies where:
  - the creditor and debtor become connected as a result of an arm's length transaction;
  - within 60 days of becoming connected, the creditor releases the debt owed by the debtor; and
  - immediately before the creditor and debtor became connected it was reasonable to assume that, without the connection (and arrangements of which it forms part), there would be a material risk that at some point within the next 12 months the company would have been unable to pay its debts.

#### 5. Where equity / assets are indirectly transferred as part of an enforcement, does that trigger adverse tax consequences?

Where there is a change of control or a break of a tax group see "Are there any adverse tax consequences arising from a change of control or break of a tax group?"

Indirect disposals of UK real estate or UK oil and gas assets by non-UK tax resident persons can trigger a charge to UK corporation tax on gains where the company being transferred is regarded as "property-rich" or derive the greater part of their value from UK and gas assets for UK tax purposes.

#### 6. Is any claw back permissible where a distressed company pays taxes for which a solvent shareholder is liable?

Under UK tax law, there are no such clawbacks.

## ACQUISITION OF DEBT

#### 1. Does the acquisition of a creditor's interest in distressed debt trigger any adverse direct tax consequences for the debtor?

There are two principal direct UK tax consequences that a debtor would need to consider where a debt is acquired by a new creditor:

- Deemed release. A so-called "deemed release" of debt may arise on acquisition where a non-connected (third party) debt is acquired by a connected (group) company of the debtor at an undervalue with the result that, post-acquisition, the debt becomes a "connected"

debt (such that the debt would become a “connected” debt post-acquisition) unless either the “corporate rescue” or “equity-for-debt” exemption apply (these exemptions broadly reflect the equivalent exemptions addressed above).

- Interest deductibility. Where the creditor changes, the debtor will need to consider whether the new creditor’s form, relationship to debtor or jurisdiction of tax residence has any impact on the debtor’s ability to deduct interest accruals on the debt for UK corporation tax purposes.

## 2. Does the acquisition of distressed debt trigger any adverse withholding or indirect tax consequences for the debtor?

Where the creditor on a debt changes, the debtor will need to consider whether any UK withholding tax arises on interest payments to the new creditor which will turn on the location and form of the new creditor. Where a UK withholding exposure arises, it will turn on the contractual drafting whether it is the creditor or debtor that bears that cost.

Typically, an acquisition of “vanilla” debt should be exempt from both UK stamp duty and VAT. However, where debt carries non-vanilla features (for instance, conversion into equity, or excessive interest) this can result in the non-availability of UK stamp duty exemptions typically relied on when transferring debt. Whilst typically these costs would fall on the acquirer, contractually any such indirect costs may be pushed onto the debtor.

## 3. What are the key tax considerations for the purchaser of a creditor’s interest on the acquisition of distressed debt?

From a creditor’s perspective the key UK tax considerations follow the choice of acquisition vehicle. Once that vehicle has been chosen, the creditor would need to consider amongst others, whether:

- There would be any UK withholding tax exposure on interest payments it receives from the UK debtor. Generally if the creditor vehicle has substance and is located in the UK or a jurisdiction with which the UK has a double tax treaty, there should be no UK withholding exposure.
- There would be any withholding exposure on interest payments it makes, including, for instance, on debt funding it has received. If the vehicle is located in the UK the same considerations set out elsewhere equally apply. However, it will be important to determine whether the vehicle is actually the beneficial owner of any interest it receives where “back-to-back” financing is in place.
- A UK vehicle would be subject to UK corporation tax in respect of interest arising on the debt on an accruals basis. Whether any corporation tax leakage will turn on the broader circumstances. Where there is “back-to-back” financing in place, applying both ordinary deductibility principles as well as transfer pricing principles, it may not be possible to fully offset any interest expense accruals (on debt owed by the UK vehicle) as against interest income accruals (on the debt owed to the UK vehicle) resulting in UK corporation tax leakage.
- There should not be any VAT or stamp duty implications on the acquisition of debt. In a UK context, typically, an acquisition of “vanilla” debt should be exempt from both UK stamp duty and VAT. However, where debt carries non-vanilla features (for instance, conversion into equity, or excessive interest) that can result in the non-availability of UK stamp duty exemptions typically relied on when transferring debt.

Finally, in the event that the creditor vehicle is incorporated outside of the UK it will be necessary to consider the governance arrangements of the vehicle to ensure that it does not become tax resident outside of its jurisdiction of incorporation on the basis of central management and control being exercised from elsewhere (including the UK).

## 4. Are there any particular beneficial regimes accessible to a purchaser of a distressed debt portfolio?

The UK has a specific tax regime applicable to securitisation companies. Where these rules apply the usual UK corporation tax position is not applicable and, instead, the vehicle is only subject to tax on its retained profits. However, whether the securitisation regime is available is highly complex and requires the satisfaction of a number of detailed conditions.

## INSOLVENCY PROCEEDINGS

### 1. What are the key insolvency procedures?

The principal insolvency proceedings in the UK are liquidations, administrations and receiverships and, as such, will form the focus of these responses.

However, for completeness, distressed companies may be subject to either a scheme of arrangement (under Part 26 of the UK Companies Act 2006) or restructuring plan (under Part 26A of the UK Companies Act 2006) as well as entering company voluntary arrangements. These are not considered further in this section.

### 2. What are the key tax considerations arising upon entry into an insolvency procedure?

Entry into insolvency procedures can result in a number of significant impacts from a UK tax perspective:

- Accounting periods.
  - Where a company enters liquidation or administration, the accounting period of the company ends and a new one begins. The primary effect of this relates to the utilisation of tax losses (including the ability to set-off trading losses as against any capital gains generated by the company in liquidation / administration) with the result that any losses arising prior to entry into liquidation or administration may become, effectively, nullified, subject to certain statutory exceptions.
  - Where a company appoints a receiver this should not alone result in the end of an accounting period and, accordingly, the concern around nullification of trading losses on liquidations and administrations is less acute. However, if there is a cessation of trade as part of the receiver appointment, such cessation of trade would also end the accounting period of the company with resulting impact on utilisation of tax losses.
- Cessation of trade. It does not necessarily follow that entry into an insolvency procedure results in the company ceasing to trade for UK tax purposes. However, where a company ceases to trade, this will bring about the end of an accounting period of the company with a new one beginning. In addition to termination of an accounting period, cessation of trade can also result in a company being required to recognise balancing charge or allowances for capital allowance purposes, market value of any trading stock, and can result in the disallowance of interest expense and trigger complex post-cessation receipt rules.
- Tax groupings. See below "Does entry into an insolvency procedure impact tax groupings?"

### 3. Does entry into an insolvency procedure impact tax groupings?

Entry into insolvency procedures can have a significant impact on UK tax groupings. The impact on UK tax groupings depends on both the specific tax group in question and the nature of the insolvency proceeding. For detail on the impact of insolvency on tax groups see our prior Weil Tax Blogs "[Tax Groups and Insolvency](#)" and "[VAT Groups and Insolvency](#)".

### 4. Are there any specific tax set offs available in an insolvency?

As a matter of general insolvency law there are a number of set-off mechanisms built into applicable rules. However, there are two specific UK tax set-offs applicable to taxpayers that are in liquidation, administration or receivership:

- VAT. Subject to certain restrictions, amounts due in respect of VAT between a taxpayer and HMRC may be set-off against another under UK VAT legislation.
- General. Subject to certain restrictions, the UK tax code contains a broad ranging set-off mechanic in respect of tax credits and debits. For instance, under this mechanism, a VAT repayment due to the company may be set-off against a payroll (PAYE) liability of the company.

#### 5. Is the tax authority a preferential creditor in an insolvency?

In the UK, HMRC is a secondary preferential creditor when a company enters insolvency but from a tax perspective only in respect of:

- VAT;
- income tax and employee national insurance contributions collected via UK payroll (PAYE); and
- deductions on account of tax under the UK construction industry scheme.

Therefore, with respect to these taxes only, HMRC ranks ahead of unsecured creditors and those holding floating charges.

Taxes arising during the course of a liquidation or administration are regarded as expenses of the insolvency proceeding. These expenses rank higher in the order of priority than preferential debts.

#### 6. Are directors or other managers personally liable for tax debts in an insolvency?

In defined circumstances, HMRC has the power to make certain directors, shadow directors, managers and shareholders of an insolvent company personally liable on a joint and several basis for the tax debts owed by the company to HMRC.

In order for HMRC to issue a notice making such individuals personally liable, the company needs to be subject to an insolvency procedure (or a serious possibility that it will be subject to an insolvency procedure) with a serious possibility that some or all of the tax debt will not be paid and either, in broad terms,:

- the company has entered into tax avoidance arrangements or tax-evasive conduct;
- the company is related to a new entity and there is evidence of "phoenixism" (i.e. where a company has entered an insolvency procedure to avoid paying tax liabilities and a new company emerges carrying on a trade or activity that is the same as, or similar to, the trade or activity carried on by the company in an insolvency procedure); and/or
- the company has received a penalty under, or proceedings have been commenced before the UK tax tribunal to impose a penalty under, provisions relating to the promotion of tax avoidance schemes, enablers of tax evasion or breaching disclosure obligations in respect of tax avoidance or tax evasion.

Equivalent rules also apply to members of an LLP.

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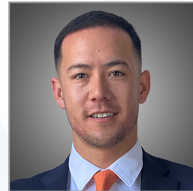
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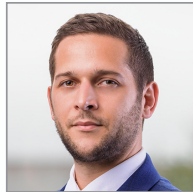
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[CLICK HERE](#) for more guides providing a high-level overview of important tax considerations for debt restructurings, enforcement, acquisitions of debt and insolvency proceedings for both debtors and creditors from UK, US, French, Luxembourg, Swiss, Belgian and Dutch tax perspectives.