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Debt restructurings: Lux, Dutch and UK tax perspectives

KEY POINTS

- Given the current macroeconomic environment, companies may struggle servicing debt or refinancing debt upon maturity, necessitating a restructuring of the debt and/or group as well as potential enforcement by creditors.
- It is important that the tax impact of debt restructurings is not overlooked otherwise there could be adverse tax implications, including tax leakage, the loss of tax assets or 'secondary tax liabilities'.

The UK, Netherlands and Luxembourg are common holding jurisdictions for international groups. Holding companies in those jurisdictions often take on third party debt, whether term loans, revolving facilities, bonds or otherwise. Given the current macroeconomic environment, companies may struggle servicing that debt or refinancing upon maturity, necessitating a restructuring of the debt and/or group as well as potential enforcement by creditors. This article sets out, at a high-level, the key UK, Dutch and Luxembourg tax issues to consider on such restructurings, primarily from a debtor perspective.

WHAT ARE THE KEY TAX CONSIDERATIONS ON A DEBT AMENDMENT?

Luxembourg

Amendments to the terms of existing debt could be considered a realization event and so trigger taxable results. The impact on the withholding tax position and deductibility of interest payments (for example, the impact of the interest deduction limitation rule) should also be considered.

Netherlands

Where an amendment to an existing debt results in a new debt for commercial / accounting purposes this could trigger taxable results. If the debt amendment results in a formal or economic waiver of debt, this may give rise to taxable debt waiver income at the level of the debtor. This may not be the case if the amendment only changes terms in a way that is more favourable for the borrower with the result that there is no formal or economic waiver of the existing debt. In addition, Dutch debtors may need to consider whether the amendment affects interest deductibility under the Dutch tax interest deduction limitation rules.

UK

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 UK debtor 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. Further, UK debtors may need to consider whether the amendment impacts interest deductibility (noting the various UK tax rules that can operate to limit interest deductibility).

WHAT ARE THE KEY TAX CONSIDERATIONS ON A DEBT REFINANCING?

Luxembourg

Repayment of an existing debt should neither give rise to withholding tax nor impact interest deductibility. As regards any new debt, general tax considerations for debt instruments apply. In principle, no withholding tax is levied on arm's length interest payments made to Luxembourg resident or non-resident corporate creditors. Withholding tax may be applicable in specific cases, for example, where the debt instrument is requalified as an equity instrument, or where the interest payment is made to an individual beneficial owner resident in Luxembourg. Interest deductibility may also be restricted by various rules.

Netherlands

Similar to a debt amendment, if a debt refinancing results in a formal or economic waiver of debt, this may give rise to taxable debt waiver income at the level of the debtor. In addition, Dutch debtors may need to consider (i) the applicability of conditional withholding tax ('CWT') (pursuant to the Dutch Withholding Tax Act 2021) on interest payments where related parties in low-tax jurisdictions or non-cooperative jurisdictions are involved or which are hybrid entities, and (ii) interest deductibility.

UK

The UK withholding tax position on interest payments (and the contractual allocation of risk) as well as the deductibility of interest payments will be important considerations. In principle interest payments by UK debtors to non-UK creditors will be subject to UK withholding tax unless treaty relief is available or a domestic exemption applies. Notably, 'payment in kind' (common in distressed scenarios) does not remove any UK withholding risk – the UK withholding regime applies equally to cash or interest satisfied through the issuance of shares or further debt. In certain cases, where discounted debt is issued, a UK debtor will

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be unable to claim a deduction in respect of the discount until such time as the debt is redeemed. It will also be important to ensure that the proposed security/guarantee package does not result in any unexpected UK tax leakage.

DOES THE RELEASE OF DEBT TRIGGER TAXABLE INCOME? IF SO, ARE THERE ANY RELIEFS OR EXEMPTIONS?

Luxembourg

At the level of a Luxembourg debtor, the release of debt triggers accounting profit, which in principle is fully taxable at a combined current rate of, approximately, 25%. An exemption may apply where the debt release is granted in view of the financial recovery of a debtor that is in financial distress if several conditions are met (*inter alia*, the debt release must be (i) definitive in nature, (ii) granted by at least a majority of the creditors, and (iii) granted exclusively in the interests of the financial recovery of the debtor). The tax treatment of debt waivers motivated by shareholder relationships is subject to different considerations. In such situations, a debt waiver could be requalified, subject to certain conditions, into a 'hidden' capital contribution, which is tax neutral. Depending on the value of such 'hidden' contribution, the waiver gain could however remain partially taxable.

Netherlands

In principle, a business-like waiver (ie, if an unrelated party would also have decided to waive the loan in the same circumstances) triggers taxable debt waiver income at the level of the debtor. A non-business-like debt waiver (ie, pursued for shareholder motives) does not result in taxable income but, rather, in a deemed capital contribution or deemed dividend distribution (as applicable). Subject to certain conditions (*inter alia* that the receivable is non-recoverable and actively waived), debt waiver income may be exempt at the level of the debtor to the extent it exceeds (i) current year losses (excluding debt waiver income) and (ii) available carried-forward tax losses (the 'Dutch Debt Waiver Exemption'). Notwithstanding, even if the Dutch Debt Waiver Exemption applies, Dutch tax may be due overall, as tax losses can only be offset against a maximum of EUR 1 million plus 50%. This outcome is at odds with the purpose of the Dutch Debt Waiver Exemption. It has been announced by the Dutch government that this unfortunate outcome will be resolved.

UK

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, a number of exemptions are available. Where the debt is between 'connected parties' for UK tax purposes releases should not give rise to taxable income for a UK debtor. Where the debt is non-connected for UK tax purposes releases should not give rise to taxable income for a UK debtor where (i) that debtor meets one of the prescribed insolvency-related conditions, or (ii) the release falls within the scope of either the 'corporate rescue' or 'debt-for-equity' exemption. Where no exemption is available it should be considered whether losses are available to shelter any UK tax leakage arising on the debt release.

ARE THERE ANY ADVERSE TAX CONSEQUENCES ARISING FROM A CHANGE OF CONTROL OR BREAK OF TAX GROUPING?

Luxembourg

A mere change of control does not impact the availability of carried-forward tax losses of the acquired Luxembourg entity. However, if such change of control is coupled with other elements such as, for example, a discontinuation of the current activity of the company and exercise of a new profitable activity, this may be characterised as an abuse of law and the use of such losses may be restricted. Where the acquired entity is part of a fiscal unity (other than as the head/parent of the fiscal unity), the change of ownership may result in the exit of that entity from the fiscal unity. If this change occurs before the expiration of a minimum five-year period as from the establishment of the fiscal unity, the group companies are re-assessed retroactively to disregard any adjustments related to the fiscal unity regime which may trigger tax. If this change occurs after the expiration of the minimum five-year period, the application of the fiscal unity regime is refused only as from the tax year in which the change of ownership occurred.

Netherlands

The breakup of a fiscal unity may trigger several trigger claw-backs provisions potentially resulting in a taxable result, such as:

- in relation to assets/liabilities that have been transferred within the fiscal unity with a higher (in case of an asset) or lower (in case of a liability) fair market value than the tax book value at the moment of the transfer, such asset/liability should be revalued at fair market value, immediately prior to the moment of leaving the fiscal unity by the respective transferor or transferee;
- receivables between fiscal unity members should be valued at nominal value or, if lower, the going-concern value, immediately prior to the moment of leaving the fiscal unity. At the same time, the debts should be valued at nominal value.

Tax losses of the fiscal unity in principle remain with the parent. Subject to certain exceptions, losses may be transferred to subsidiaries leaving the fiscal unity to the extent those losses are attributable to those subsidiaries. Similar rules apply in respect of carry-forward interest under the earnings stripping rule and other tax attributes.

Companies included in a fiscal unity are jointly and severally liable for the Dutch corporate income tax ('CIT') debts of the entire fiscal unity for the period during which they were part of the fiscal unity. This liability will in principle only materialise if the parent fails to remit the CIT due to the Dutch tax authorities.

The break-up of a fiscal unity for Dutch VAT purposes should not trigger similar claw-backs as described above. However,

Biog box

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note that members of a VAT fiscal unity may be secondarily liable for VAT of other group members for the period in which the subsidiary was part of such fiscal unity.

UK

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 of 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 8 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.

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 (eg following an enforcement by the creditor) unless the 'corporate rescue' exemption applies.

ARE THERE ANY ADVERSE TAX CONSEQUENCES ON THE ACQUISITION OF DISTRESSED DEBT?

Luxembourg

Any gains realised by a Luxembourg company acquiring distressed debt constitute regularly taxable income. Where the gain is offset against interest expenses, the application of the interest deduction limitation rule (at the level of the acquirer) should be considered. Where the acquirer of distressed debt issued by a Luxembourg debtor is not a resident of Luxembourg, the acquisition of distressed debt should not give rise to specific adverse Luxembourg tax consequences. From the perspective of the Luxembourg debtor, the withholding tax position with respect to the new creditor should be verified.

Netherlands

The transfer of a receivable by a creditor does not, in principle, have any tax consequences for the debtor. If the receivable is transferred to the debtor itself this may result in debt waiver income at level of the debtor, for example, if the receivable is transferred for an amount below nominal value. Subject to certain conditions being met, the Dutch Debt Waiver Income Exemption may apply. In addition, Dutch debtors may need to consider the CWT position (in case of a new creditor) and interest deductibility.

UK

When a debt is acquired the UK tax impact will turn on a number of factual points including who the purchaser is (eg if it is a group member or third party), where the purchaser is located and what form it takes. However, the key UK tax considerations to consider include whether:

- a so-called 'deemed' release of the debt arises on acquisition, which can generally occur where a non-connected (third party) debt is acquired by a connected (group) company of the debtor (such that the debt would become a 'connected' debt post-acquisition) at an undervalue unless either the 'corporate rescue' or 'equity-for-debt' exemption apply;
- securitisation or other similar regimes could be accessed by the purchaser of a distressed debt portfolio;
- any UK withholding tax arises on interest payments to the new creditor;
- interest deductibility is effected post-acquisition; and
- any indirect taxes (stamp duty or VAT) are triggered on the acquisition of the debt (although, typically, an acquisition of 'vanilla' debt should be exempt from both UK stamp duty and VAT).

IS THERE ANY ADVERSE TAX IMPACT IN RESPECT OF COMMON RESTRUCTURING FEES, FOR EXAMPLE, CONSENT FEES?

Luxembourg

Common restructuring fees (such as consent fees or backstop fees) paid by a Luxembourg debtor should be treated as regular expenses deductible for Luxembourg tax purposes, to the extent they are at arm's length. The impact of the payment of such restructuring fees on the interest deduction limitation rule should also be considered. Backstop fees should generally not attract Luxembourg VAT, whereas consent fees may in principle attract Luxembourg VAT at 17% (subject to VAT localisation rules).

Netherlands

Financing related costs (ie costs that are made to obtain the financing) should generally be tax deductible, assuming that the interest expenses on the debt itself are tax deductible. Financing costs may be deductible at once, but there are ongoing discussions whether financing costs should be capitalised and amortised over the term of the loan to which the financing costs relate. We note that financing costs (banking fees, etc) may also qualify as 'interest' under the Dutch earnings stripping and CWT rules which could require further attention.

UK

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. ■

Further reading

- Lexis+ UK; Restructuring & Insolvency; R&I spotlight; R&I spotlight on tax; Debt restructurings – tax issues on debt restructurings
- Astle and Lamb: Direct Lending in a distressed world (2022) 6 JIBFL 405
- Doak and Pibworth: UK companies in distress: a tax refresher (2020) 3 CRI 85