

Changes to the LMA's Leveraged Facility Agreement: HMRC's Double Taxation Treaty Passport Scheme

HMRC announced in June the launch of its Double Taxation Treaty Passport ("DTTP") scheme for overseas corporate lenders who rely on a double tax treaty for relief from withholding tax on interest payments by or from UK borrowers. The DTTP scheme becomes operative on 1st September.

In our June 2010 Financing Briefing "[The HMRC DTTP Scheme – what corporate borrowers need to know](#)" we outlined the background to the DTTP scheme, its main features and some of its potential implications for corporate borrowers and loan documentation.

The Loan Market Association ("LMA") recently published a revised version of its recommended form of facility agreement for leveraged transactions (the "Leveraged Agreement"). The substantive changes all relate to the new DTTP scheme. We expect this wording will be used in new investment grade as well as leveraged loan documentation going forward.

This Briefing summarises the changes to the LMA Leveraged Agreement and considers their implications from a Borrower's perspective.

THE CHANGES

The changes to Clause 18 (*Tax Gross-up and indemnities*) of the Leveraged Agreement provide a framework to enable a Treaty Lender with a DTTP to apply its DTTP to any utilisation under the facilities if it chooses to do so. If a Treaty Lender elects to use its DTTP:

- if it is an Original Lender (a Lender who is party to the facilities agreement at signing), its DTTP scheme reference number must be included in a Schedule to the agreement;
- if it is a Lender who has become party to the facilities agreement after signing, its DTTP scheme reference number must be included in the Transfer Certificate, Assignment Agreement or Increase Confirmation pursuant to which it accedes to the facilities agreement.

If a Treaty Lender indicates (as described above) that it wishes to use its DTTP, the onus is on the Borrower to file the required form with HMRC (form DTTP-2) within 30 days of either (i) the date of the agreement (for Original Lenders) or (ii) in the case of Lenders who join the syndicate after signing, the date on which their accession takes effect.

Clause 31.2 (*Additional Borrowers*) and the forms of Transfer Certificate, Assignment Agreement and Increase Confirmation in the Schedules to the Leveraged Agreement have also been amended to reflect the changes to Clause 18.

THE BORROWER'S PERSPECTIVE

DTTP Lenders are not obliged to use the DTTP

An important point for Borrowers is that Treaty Lenders with a DTTP are not obliged under the LMA's provisions to apply their DTTP to the facilities. The new provisions state expressly that Treaty Lenders who have registered for the scheme are not obliged to use their DTTP and Lenders who have not registered are not obliged to register.

The LMA appears to have taken this "opt-in" approach to address the possibility that a particular loan entered into by a Lender who happens to hold a DTTP, may not satisfy the conditions for DTT relief. If that is the case, Borrowers will, of course, argue that the Lender in question should not be a "Treaty Lender" at all for the purposes of the tax gross-up provisions. Borrowers may also justifiably take the view that a Treaty Lender with a DTTP should be obliged to use it in any situation where the conditions for DTTP relief are satisfied. As the LMA notes in its User Guide to the Leveraged Agreement (which has also been updated for the DTTP scheme), all expectations are that Lenders and Obligors will wish to use the DTTP scheme wherever possible.

HMRC plans to make available an on-line database of registered DTTP lenders. Borrowers should (from 1st September) be able to search the database, to determine whether its Lenders or potential Lenders hold a DTTP. This may be a helpful means for Borrowers to verify the DTTP status of individual Lenders, but it will still be important for Borrowers to seek specific assurances from DTTP Lenders that they are entitled to use their DTTP in relation to the facilities in question, and if so entitled, that they will do so.

Ability to comply with DTTP filing obligations on time

As noted in our previous Briefing, HMRC's DTTP terms and conditions place the obligation on the Borrower to file DTTP-2 with HMRC within 30 days of entry into the relevant loan relationship. The LMA drafting reflects that position, but Borrowers may face some practical difficulties when seeking to comply with their filing obligations.

Original Lenders are required to include their DTTP scheme reference number (if they wish to use it) in the agreement, so the Borrower should have the information it needs to complete and file DTTP-2 within 30 days of signing.

However, in relation to (i) Lenders who join the syndicate subsequently and (ii) existing DTTP Lenders who take on further participations after signing (in which case a further DTTP-2 must be filed), there is a risk that the Borrower may not receive notice of the Lender's DTTP status in time to comply with its filing obligations. All the Lender is required to do is to include its DTTP scheme reference number in the relevant Transfer Certificate, Assignment Agreement or Increase Confirmation (to which the Borrower is not a party). Clause 29.7 (*Copy of Transfer Certificate, Assignment Agreement or Increase Confirmation to Parent*) requires the Agent to send such documentation to the Parent "as soon as reasonably practicable" after execution by the Agent, which may or may not be in sufficient time to make the required filing.

DTTP Lenders should be obliged to provide the Borrower with their DTTP scheme reference number and any other relevant information in sufficient time to enable the Borrower to comply with its obligations.

Lenders may argue that Borrowers can determine Lenders' DTTP status independently by searching the HMRC database (referred to above). However, to conduct a search, the Borrower needs to know the identity of the Lenders (which it may not prior to receipt of e.g. a Transfer Certificate), and in any event, the DTTP-2 cannot be filed until the relevant Lender has confirmed that its DTTP applies to the facilities.

Consequences of failure to file a DTTP-2 on time

If the Borrower breaches its contractual obligation under the facilities agreement to file the DTTP-2 within 30 days, a Default will occur, and all of the negative consequences that entails for the Borrower. This does not seem appropriate where the Default is the result, for example, of a Transfer Certificate not being delivered to the Borrower within 30 days, or of a Lender providing an incorrect DTTP reference number to the Borrower.

Borrowers will argue that a breach of any DTTP-2 filing obligation should not result in a Default under the facilities agreement if the breach is the result of the Agent's or the relevant Treaty Lender's failure to provide it on time with the information it needs properly to complete and file the DTTP-2.

Lender's failure to provide correct information

If a Treaty Lender elects to use its DTTP and provides its DTTP reference number, the LMA drafting states that it does so "for the benefit of the Agent and without liability to any Obligor". Borrowers may wish to delete that language. If a Lender turns out not to be entitled to the DTTP it holds (for example it has provided HMRC with incorrect information) or if it simply includes an incorrect reference number, the Borrower could become liable to HMRC for any withholding not made, or become required to gross-up that Lender as a result of the delay under the terms of the facilities agreement.

Borrowers may wish to consider whether Lenders who either (i) do not provide the Borrower with correct information in sufficient time to file DTTP-2 within 30 days or (ii) have indicated to the Borrower their entitlement to apply their DTTP to the facilities but who turn out not to be so entitled, should be excluded from the benefit of the tax gross-up provisions in addition to being required to reimburse the Borrower should HMRC seek to recover any tax payable from the Borrower.

What happens if a Lender obtains a DTTP after becoming a Lender?

The LMA's changes do not address what happens if a Treaty Lender registers for the DTTP scheme after it becomes a Lender. If the usual DTT clearance route has been followed in respect of that Lender and a direction has been applied for and received, then there would be no reason for the Lender to use its DTTP. If, however, either (i) a direction has not yet been obtained (i.e. the Treaty Lender registers for a DTTP in the interim) or (ii) an existing Treaty Lender acquires a new participation in the facilities (necessitating a new direction application) and has by that time acquired a DTTP, Borrowers will want to be notified so that the DTTP can be applied to the facilities.

What happens if a Lender's DTTP (or DTTP direction) expires?

DTTPs are to be issued for a term of 5 years and DTT directions are usually issued for a period of 5 years. In some circumstances, as noted in our June Briefing, it may be appropriate for Borrowers to seek undertakings from DTTP Lenders to renew their DTTPs on a timely basis, to facilitate the process of obtaining a new direction. No such undertakings are included in the LMA drafting.

When will the new provisions be relevant?

The DTTP scheme is effective for loan relationships entered into on or after 1st September 2010. DTTP-2 forms can only be filed after that date. The Borrowers' obligations under the new LMA provisions apply only if the facilities agreement is dated after 1st September, or if a new Borrower or new Lender accedes to an agreement dated prior to 1st September, after that date. Borrowers currently negotiating facilities which are likely to involve Treaty Lenders should discuss with their advisers the incorporation of appropriate contractual provisions to ensure that the Borrower is able to make full use of the DTTP scheme where available.

Borrowers may be able to make use of the DTTP scheme in relation to existing facilities. It may be worthwhile amending facilities which extend beyond 1st September to address the DTTP scheme. This

might be appropriate, for example, if it is likely that participations will be transferred to Treaty Lenders after 1st September.

Tax risk pending receipt of DTTP direction

As noted in our previous Briefing, it appears that Borrowers will be unable to apply the Treaty rate of withholding tax in reliance on a Lender's DTTP passport status prior to receipt of a direction from HMRC. While the process of obtaining a DTTP direction is expected to be considerably quicker than the existing DTT clearance procedure, Borrowers who are able to do so must continue to protect themselves against the risk of being required to gross-up a Treaty Lender pending receipt of a direction.

Changes to the LMA facility agreements for investment grade borrowers

The LMA's facility agreements for investment grade transactions have not yet been amended for the DTTP scheme. Changes to those agreements are subject to discussions between the LMA and the Association of Corporate Treasurers prior to publication, and are expected in due course.