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Insights

NON-UK CORPORATE LANDLORDS: TAX AND DEBT RESTRUCTURINGS

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SUMMARY

From 6 April 2020, all non-UK resident corporate landlords (**NRLs**) are within the charge to UK corporation tax on the income from their UK property rental business (**PRB**) and on capital gains from direct or indirect disposals of UK real estate. This marks a significant change for NRLs, which were previously subject to UK income tax on their PRB income and (until 6 April 2019) exempt from UK tax on their capital gains.

The UK corporation tax regime is generally more complex than the UK income tax regime. For example, the rules on usage of losses are more complicated, while, in addition to transfer pricing, corporation tax payers are also subject to additional restrictions on interest deductibility (including the corporate interest restriction rules and the hybrid rules). In fact, the tax regime relating to loans and debts generally (usually referred to as "the loan relationships rules") is significantly more intricate than for income tax, including a number of anti-avoidance concepts and provisions. This blog considers one area where there is a different tax treament, that of debt restructurings.

Broadly, if a debt is released (in whole or in part), it may give rise to a taxable profit if a profit is realised for accounting purposes. There are, however, a number of exceptions to this general rule:

- **"Statutory insolvency arrangements":** If a debt release is made as part of "statutory insolvency arrangements", it will not give rise to a tax charge. Note that for these purposes, the term "statutory insolvency arrangement" does not include a number of insolvency procedures (these are dealt with in the next bullet point) but only extends to a voluntary arrangement under the Insolvency Act 1986, a Companies Act 2006 Part 26 arrangement, or (in the case of a non-UK debtor) overseas equivalents.
- **Debtor insolvency**: If a debtor is insolvent, it will not be subject to tax on any release of a debt it owes (though this does not apply to connected party debts). For these purposes, a debtor is

insolvent if it is in insolvent liquidation, insolvent administration, insolvent administrative receivership, a provisional liquidation or (in the case of a non-UK debtor) overseas equivalents.

- **Corporate rescue exemption:** An accounting profit from a debt release will not be taxable if the corporate rescue exemption applies. The exemption applies where it "*is reasonable to assume that without the release…there would be a material risk that at some time within the next 12 months the company would be unable to pay its debts*". There are provisions that explain further the "unable to pay its debts"test, which HMRC intend to be interpreted and applied in a similar way to s123 Insolvency Act 1986.

- **Debt-for-equity swaps:** A debt release as part of a debt-for-equity swap where the debt is converted into ordinary shares will generally not give rise to tax for the debtor. It should, however, be borne in mind that in guidance HMRC have stated that the exemption may not apply where there are arrangements for the lender to immediately sell the shares for cash.

- **Connected companies:** Generally, where a debt between connected companies is released, the debtor is not subject to tax on the 'profit' arising from the release. This is subject to a number of exceptions and anti-avoidance rules. In particular, it is worth noting that tax charges can arise where distressed debt is acquired into the group in order to waive it and also where the parties to an impaired debt become connected (though there are some safe harbours).

All of the exceptions summarised above are subject to further conditions being satisfied, so it is important to check that they apply on the particular facts.

It is also worth bearing in mind that insolvency and debt restructurings can have other tax consequences. For example, they could result in various tax groupings being broken, which could lead to separate tax charges and to losses becoming unavailable.

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