HM Revenue and Customs

By email: interest-restriction.mailbox@hmrc.gsi.gov.uk

23 February 2017

Dear Sirs,

Re: Corporate Interest Restriction – Draft Legislation published on 26 January 2017

We are writing on behalf of the British Private Equity and Venture Capital Association (the "BVCA"), which is the industry body and public policy advocate for the private equity and venture capital industry in the UK. With a membership of almost 600 firms, the BVCA represents the vast majority of all UK based private equity and venture capital firms, as well as their professional advisers. While our membership is predominantly focussed on private equity and venture capital, a significant number of our members are active in infrastructure, debt and real estate. These types of alternative funds are a growing source of finance for investment by business.

Our members have invested over £30 billion in nearly 3,900 UK-based companies over the last five years. Companies backed by private equity and venture capital in the UK employ around 490,000 people and almost 90% of UK investments in 2014 were directed at small and medium-sized businesses. The availability of debt finance facilitates this investment in business and jobs growth and the benefits of debt finance in the broader economy should not be underestimated.

We have set out in previous responses the issues we regard as most important to the private equity and venture capital industry in relation to the introduction of any corporate interest restriction. We acknowledge that a request for a more generous transitional regime is unlikely to be forthcoming. We also recognise that some sensible attempts have been made to reconcile some of the anomalies that may arise as a result of differences between tax and accounting EBITDA in relation to the group ratio exception, even if the effect of non-UK operations on the group ratio have not.

The key part of the January draft for our industry, however, has been the definition of related party debt and we have a number of comments on the proposals which we should be grateful if you would consider.

Section 451

The attribution of rights and interests is widely drawn.

We have previously highlighted how, in the international funds context, a very wide definition could result in what one might ordinarily regard as genuine third party debt being treated as related party debt and therefore excluded for the purposes of the group ratio exception.

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We acknowledge that you have sought to address one area of concern in section 451(5), e.g., where two different funds with two different investment strategies happen to be managed by the same asset manager. We do, however, have a number of observations on this and on the application of section 451 to funds more generally:

A. Section 451(5) – Funds managed by the same person

Section 451(5) works where the funds in question are both collective investment schemes and the operator of each fund is the same person. This will rarely be the case. Funds established as limited partnerships and open-ended vehicles will generally constitute collective investment schemes but closed-ended non-UK corporate fund vehicles will not – and these vehicles are not now uncommon in the funds sector. One way to address this would be to include both collective investment schemes and alternative investment funds for the purposes of AIFMD within section 451(a).

Similarly, the operator of a limited partnership will typically be the general partner and each limited partnership, for purposes of ring-fencing liabilities, will have its own general partner. They will not, therefore, have the same operator and the 'management' of the funds will generally be carried out by a separate entity, i.e., the asset manager / adviser. We would therefore suggest that 451(5) be extended to cover funds which are managed and / or advised by the same asset management house.

B. Same investor in two separate funds

As mentioned in our earlier representations, it is now perfectly possible to imagine scenarios in which a private equity fund, Fund A, acquires a UK portfolio company and finances that acquisition with third party debt, e.g. from a bank or from an unrelated debt fund, Fund B.

If the provisions of section 451(1) operate as widely as currently proposed, without exception, it seems to us that if an investor in Fund A has also invested in Fund B, any leverage from Fund B to finance the acquisition could be regarded as related party debt, particularly where Fund A and Fund B are both established as limited partnerships. This cannot be right.

The bank debt could also be caught if the bank is connected or otherwise related to one of the investors in Fund A. The draft legislation attempts to address this potential issue in section 455. We would, however, suggest that the relevant test in section 455(1) should not be awareness, which begs the question of how much due diligence the bank should have to carry out to determine this, but whether the bank and the relevant Fund are acting in concert.

We would also suggest that section 455 should not be limited to banks and should extend to cover the Fund A and Fund B scenario described above.

Section 452 – Guaranteed Debt

Section 452 currently provides that, where a third party loan is guaranteed by a related party of the borrower, that third party loan will be treated as related party debt for the purposes of Chapter 11.

In the context of a typical private equity transaction, all senior and other third party debt in the structure will be guaranteed by all the material companies in the relevant target group. As currently drafted, therefore, nearly all bank and other third party debt in respect of a private equity investment would be treated as related party debt. We do not believe that this can have been intended as it cuts entirely across the whole underlying policy objective of the group exception which, to all intents and purposes, was meant to benchmark the borrowing capacity of the worldwide group.

At the very least, therefore, we would suggest that, if this provision is to be retained, any guarantee from a related party within the worldwide group should be ignored.

As always, we hope that the comments and responses above are helpful. We would, of course, be very happy to discuss any of them with you further.

Yours faithfully,

Mark Baldwin

Chairman of the BVCA Taxation Committee