

Debt restructuring, and ultimately formal insolvency, give rises to possible tax implications for borrowers, lenders and guarantors. The tax implications arising from business restructuring should not be underestimated. Attempts to improve a company’s cash-flow position through debt restructuring can inadvertently trigger tax liabilities which could undermine the efficacy of such moves.

The table below summarises some of the key tax issues from business restructuring.

Procedure	Debtor Position
<p>Debt Renegotiation (i.e. an agreement to amend the terms of an existing debt)</p>	<ul style="list-style-type: none"> • Potentially taxable credit (profit) if the borrower’s obligations become less onerous • Exception for corporate rescues – that is, where “it is reasonable to assume that, without the release and any arrangements of which the release forms part, there would be a material risk that at some time within the next 12 months the company would be unable to pay its debts” • Consider deductibility of new interest payments (especially if lending is from associated/connected entity) • If any accrued (but unpaid) interest is capitalized as part of the renegotiation, there may be a deemed interest payment – consider any withholding tax exposure that may arise
<p>Debt Refinancing (i.e. an agreement to replace an existing debt with a new facility)</p>	<ul style="list-style-type: none"> • Consider withholding tax obligations on new interest payments (especially if refinancing involves the issue of funding bonds (payment-in-kind, PIK, notes) – withholding will still apply and may need to be met by issuing PIK notes to HMRC) • Again, if the refinancing results in accrued (but unpaid) interest being capitalized, there may be a deemed interest payment – consider any withholding tax exposure that may arise • Consider deductibility of new interest payments (especially if refinancing involves the issue of a discounted instrument – although this eases cash-flow pressure by eliminating payment of interest, no deduction will be available in respect of the discount)

Procedure	Debtor Position
<p>Debt Impairment and Release (including 'deemed debt releases' where either:</p> <ul style="list-style-type: none"> a. a group company acquires the creditor rights under an impaired debt of a connected debtor company from a third party lender at an undervalue, or b. an unconnected lender and debtor under an impaired debt become connected) 	<ul style="list-style-type: none"> • Potentially taxable credit (profit) on element of debt release • Exceptions may be available for releases under: <ul style="list-style-type: none"> – A statutory insolvency arrangement (i.e. any voluntary arrangement under the Insolvency Act 1986 or any compromise under Part 26 of the Companies Act 2006 (or similar) – Debt-for-equity swaps [see below] – (Unconnected relationships only) the company is in insolvent liquidation, administration, administrative receivership (or similar) – Corporate rescues (i.e. where, immediately before the release, "it is reasonable to assume that, without the release and any arrangements of which the release forms part, there would be a material risk that at some time within the next 12 months the company would be unable to pay its debts" • Where creditor is non-UK, consider possible counteraction under anti-hybrid rules (where release is exempt for debtor but creditor is able to claim deduction) • Consider application of 'targeted anti avoidance rule' (TAAR)
<p>Debt-for-Equity Exchanges (i.e. creditor accepts issue of shares in debtor company in exchange for releasing debt)</p>	<ul style="list-style-type: none"> • Credit (profit) on element of debt release should be exempt • Multiple conditions (e.g. shares issued must be ordinary share capital) limit scope of exemption • Also, consider effect on: <ul style="list-style-type: none"> – Tax groupings – Creation of connected parties (and consequences)

NB: Different, (and in certain circumstances) more complex, rules apply to creditor and guarantor companies.

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