Tax Flash

«Tax provisions in the context of the PSI program and other provisions modifying the tax treatment of bonds – derivatives»

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The new provisions introduce, inter alia, an explicit exemption for gains arising from the PSI driven exchange, but also special provisions for the deductibility of losses.

Within the context of application of the tender for exchange of securities as part of the Greek debt restructuring program (PSI) three legislative acts were recently enacted, i.e. Laws 4046/2012, 4050/2012, and 4051/2012. Such acts include the following tax provisions governing certain tax issues that arise with respect to such program, but also introducing new aspects in what concerns taxation of bonds and derivatives in general. To be noted that no interpretative guidance has been issued in respect of such provisions, and we do not exclude the possibility of further amendments in the near future.

1. **Tax treatment of bond interest and capital gains or losses arising from the bond exchange under the PSI program**

- The law stipulates that the exchange of bonds from their current holder with other instruments in the context of the Greek debt restructuring program (PSI) will not be considered as affecting the nature of such bonds as held to maturity (when this is the case) until their new maturity for the purposes par. 11 of art. 12 of the Greek Income Tax Code (ITC), so that the tax exemption from interest WHT provided in such article is not affected.

- The tax treatment of interest arising from bonds issued by the EFSF upon execution of the PSI will be equalized to that of bonds issued by the Greek State.

- A provision is introduced whereby for the holders of Greek State bonds or corporate bonds guaranteed by the Greek State, who participate in the PSI program, and in this context acquire new bonds issued by the EFSF, the WHT on the discounting of interest with new bonds will be due at the maturity of the new bonds issued.

  It needs to be clarified whether this applies also for bonds that are held to maturity.

- Capital gains arising from the exchange in the context of the PSI will be exempt from taxation.

- The negative difference arising for legal entities from the above exchange will be tax deductible throughout a period ending at maturity of the new bonds received, in equal annual installments starting from the year in which the exchange takes place, and regardless of whether the new bonds are held to maturity.

- The GDP-linked securities issued by the Greek in the context of the PSI are equalized, for tax purposes, to derivative products. Some new tax provisions introduced for derivatives are depicted below.

2. Other tax provisions introduced with respect to the taxation of bonds – derivatives

The new provisions regarding taxation of gains from the transfer of State and corporate bonds, but also gains/income from derivatives, should be carefully taken into account, particularly in what concerns non-resident beneficiaries

- An explicit provision whereby the gain arising from the transfer of Greek State and corporate bonds is considered as securities income under article 24 of the ITC is introduced.

  The practical implications of such provision need to be thoroughly considered, since it is unclear whether such new provision introduces a WHT obligation at any circumstance of a sale at a gain, with particular emphasis on cases of non-resident bondholders. In the latter case there would be ambiguity even as to the applicable WHT rate.

- The credit balance arising from 2011 tax returns and onwards of credit institutions operating in Greece, may be set off against the income tax due of such entities for 5 consecutive years after the creation of such balance, to the extent that such balance is created by tax that has been withheld on Greek State bond, T-Bill and corporate bond interest.

3. Tax treatment of derivatives

- The currently applicable tax exemption (as it applies) for capital gains arising from listed derivatives is extended to the GDP linked securities issued by the Greek State in the context of the PSI. On the other hand, such securities are also included within the definition of derivatives in accordance with art. 24 of the ITC, whereby income arising therefrom is in certain cases subject to a 15% WHT per art. 54 of the ITC.

  From the combination of the provisions it appears that the capital gains exemption will apply only in the case of the listed securities, whilst the 15% WHT will apply to non-listed. In general however, the new provisions on derivatives may still create confusion and unclear distinction between the notions of income, return or gains from derivatives.

- Income arising for a foreign resident, whether individual or legal entity, from derivatives, as these are defined in Greek legislation, is explicitly listed as "securities income" in the meaning of article 24 of the ITC.

  This provision as well creates practical and interpretational issues, as to how the relevant articles of Greek ITC which impose WHT on securities income would apply in case of non-resident beneficiaries.

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