Memo

To SCM Approvals Committee

Сору	
From	Michael Keeley
Date	2 March 2007
Subject	Project Brontos

SUMMARY

- 1. SCM seeks approval to present Project Brontos to the Milan Branch of Barclays Bank PLC ("**Milan Branch**").
- 2. Project Brontos involves Milan Branch entering into a Repo with an Italian Counterparty (the "Counterparty") over a profit participating instrument ("PPI") issued by a Barclays entity in Luxembourg.
- 3. The counterparties identified for the transaction are Unicredito Italiano S.p.A group ("**Unicredito**") and Intesa Sanpaolo S.p.A group ("**Intesa**"). It is envisaged that the transaction with Unicredito would be a TRY based transaction of up to €[2,500]m, and the transaction with Intesa would be a GBP based transaction of up to €[1,000]m. The transaction with Unicredito may comprise of separate Repos with up to three separate entities in the Unicredito group.
- 4. Overall under Project Brontos, the Counterparty will make an investment with Milan Branch. The Counterparty achieves an enhanced pre tax return and will receive distributions which should be largely tax exempt while their funding costs and associated expenses should be fully tax deductible. Barclays' benefit arises through sub-Libor funding from the Counterparty.
- 5. Subject to approval of the transaction, it has been agreed that SCM will provide resource to the Milan Branch locally in order to facilitate the Milan Branch's origination, management and execution of the trade for as long as is necessary.
- 6. The version of the transaction outlined in this paper involves a TRY denominated PPI and an associated currency hedge (the Unicredito version). It is envisaged that Intesa will enter into a version of the transaction using a PPI denominated in another currency (GBP, EUR or USD). Intesa may or may not require currency hedging for such a transaction
- 7. As part of the transaction, Barclays will represent that the payments under the PPI would benefit from the Italian tax exemption in the hands of Milan Branch were they to be received by the Milan Branch, i.e. had Milan Branch not transferred the PPI under the Repo. The Counterparties' benefit is dependent on the repo seller (Milan Branch) being able to satisfy this condition. As such, Barclays would indemnify the Counterparties for any loss of benefit as consequence of the representation not being satisfied (see paragraph 121). The maximum loss that would arise if the representation was incorrect is €[52.8]m per annum per €[1,000]m investment for the Unicredito trade and €[14.2]m per annum per €[1,000]m investment for the Intesa trade. You will see from the Italian tax opinion in Appendix 2 that based on our facts the representation should be satisfied.
- 8. Diagrams showing the transaction steps, including ongoing flows and unwind, are provided in the detailed description which begins on page 3.

Economic Benefit

9. Key financial data is set out below.

Product Limit per annum	€150m of WHT across all jurisdictions, with the outstanding reimbursement due not to exceed €100m at any one time. The proposed transactions would use up to €[65]m in 2007 ¹ .
Estimated revenue per annum per trade (PTE, pre-provision):	€[22.6]m ² on a trade with a €[1,000]m investment (assuming a TRY based trade) €[6.08]m ³ on a trade with a €[1,000]m investment (assuming a GBP based trade)
Tax capacity per annum	Nil
Return on Tax capacity:	n/a
WRAs	€[2]m per transaction
Return on WRAs	
PUG	Nil
Tenor	Less than 1 year.

- 10. This paper assumes a transaction size of €[1,000]m for the purposes of illustration and a benefit split of 70:30 (prior to the cost of funding the tax reimbursement, which will be borne by Barclays) in favour of the Counterparty. It is assumed that the transaction terminates within 12 months. The assumed corporate tax rates in Italy and the UK are 33% and 30% respectively.
- 11. This paper contains a description of all significant tax, credit, market and operational risks.

DETAILED DESCRIPTION

This description assumes a TRY:EUR spot rate of TRY2:EUR1, Euribor = 5% and TRY Libor = 20%.

Where the following description refers to TRY amounts, in practice these amounts will be settled in Euros for the euro equivalent of the given TRY amount, translated at the prevailing spot rate.

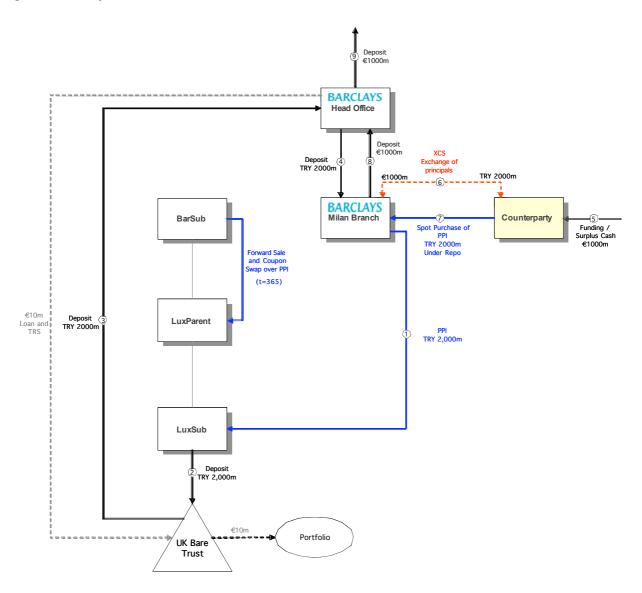
- 12. An investment company subsidiary of BBPLC which is tax resident in the UK ("**BarSub**") establishes a wholly owned subsidiary in Luxembourg, with €[25,000] ordinary shares ("**LuxParent**"). LuxParent will be a Sarl.
- 13. LuxParent establishes a wholly owned subsidiary in Luxembourg, with €[20,000] ordinary shares ("LuxSub"). LuxSub will also be a Sarl. Additional LuxSub entities may need to be established for each transaction with a different Counterparty.
- 14. LuxParent will use the €[5,000] of cash it retains to meet initial expenses, and places the remainder on deposit.
- 15. LuxParent and LuxSub place the subscription proceeds on deposit.
- 16. LuxSub will enter into an agreement with LuxParent whereby LuxSub must seek written consent from LuxParent before any issuance or transfer of any profit participating instruments (e.g., PPI).

¹ [In 2007, other trades are expected to use approximately €22.5m of the WHT limit.

² Note that the 2007 revenue will be a proportion of this number dependent on the close date for the transaction. This number does not include cost of collateral, expected to be approx. €1.5m p.a.

³ Note that the 2007 revenue will be a proportion of this number dependent on the close date for the transaction.

Figure 1: Principal Flows



- 17. Barclays Bank PLC, London ("Head Office") utilises a TRY[2,000]m overdraft facility to make a deposit with Milan Branch (the "Milan Branch TRY Deposit").
- 18. Milan Branch subscribes for a TRY[2,000]m PPI issued by LuxSub with a term of [20] years.
- 19. Milan Branch is the legal and beneficial owner of the PPI. The key features of the PPI are provided in Appendix 1.

UK Bare Trust

- 20. LuxSub will establish a UK Bare Trust (the "**Trust**") and uses the proceeds of the subscription in the PPI to settle it with TRY[2,000]m.
- 21. The Trust will have three assets (the "**Portfolio**"). The Portfolio will be funded by a €[10]m loan from BBPLC to LuxSub.
- 22. The trust agreement will also provide for the Trustee to invest in a fourth asset in the form of a short term (i.e. less than 365 days) TRY[2,000]m deposit with Head Office (the "**Barclays TRY Deposit**").

- 23. Further details of the Trust are provided in Appendix 1.
- 24. Head Office uses the proceeds of the Barclays TRY Deposit to repay its TRY overdraft facility.

Counterparty Repo and Cross Currency Swap

- Counterparty raises €[1,000]m of new funding from the market or sources this from surplus cash. 25.
- Milan Branch enters into a cross currency swap (the "CCS")⁴ with the Counterparty with the 26. following features:
 - 26.1. The maturity of the CCS is equal to the term of the Counterparty Repo.
 - 26.2. An initial exchange of principal under which the Counterparty pays €[1,000]m and Milan Branch pays TRY[2,000]m.
 - 26.3. Ongoing payments under which Milan Branch plays Euribor interest + Euro spread and Counterparty pays TRY Libor interest + TRY spread°.
 - A final exchange of principal under which Counterparty pays TRY[2,000]m and Milan 26.4. Branch pays €[1,000]m.
 - 26.5. All payments under the CCS will likely be settled in Euros.
- 27. Milan Branch now has €[1,000]m of cash, and places this on deposit with Head Office in line with its normal business practice (the "Milan Branch EUR Deposit") .
- 28. Head Office makes a deposit of €[1,000]m with the market (the "Market EUR Deposit").
- 29. Shortly thereafter but on the same date that it enters into the CCS, Milan Branch enters into a sale and repurchase agreement with the Counterparty over the PPI (the "Counterparty Repo"), whereby it sells the PPI and agrees to repurchase it on the next distribution payment date⁶.
- 30. The Counterparty repo will roll into a repeat repo transaction on the same terms via a Repo Confirmation (under the Master Repo arrangements) signed by both parties.
- 31. The Counterparty may also provide notice that it intends to enter into a repeat repo transaction over instruments with a different total principal amount (see paragraph 45).
- 32. The repurchase price under the Counterparty Repo will be calculated in accordance with the following formula⁷:

Where:

P = the purchase price

I = TRY Libor + TRY spread.

GD = the amount of distributions under the PPI gross of Luxembourg withholding tax levied at source.

33. As the amount of the distributions paid on the PPI is subject to a cap (see Appendix 1, para 1.2), the difference between the initial purchase amount and the repurchase price will be either zero or a positive amount. Specifically, the repurchase price will be greater than the purchase price by the amount of the spread on the interest leg of the repurchase price calculation.

⁴ The version of the transaction outlined in this paper involves TRY denominated instruments and an associated hedge. Other versions of the transaction using instruments denominated in other currencies (including GBP, EUR and USD), which the Counterparty may or may not require hedging, are also envisaged. This is likely to be the case in the Intesa trade.

Since the spread under the repo is in TRY, the CCS also swaps the TRY spread into a EUR spread.

⁶ Other versions of the transaction using instruments denominated in other currencies (including GBP, EUR and USD) may have a Repo with a longer term.

As an alternative, the repo price could be equal to 'P' above and the flows 'i – GD' may be settled via a swap agreement which will constitute one contract together with the repurchase agreement. Furthermore, the formula may include amounts representative of interest on reinvestment amounts where appropriate.

- 34. Where required Milan Branch will make a representation to Counterparty under the Counterparty Repo that it would itself have been able to benefit from exempt income for Italian Tax Purposes on the return paid on the PPI had it not entered into the Counterparty Repo.
- 35. Milan Branch and Counterparty may also enter into a foreign exchange hedging arrangement for a notional amount equal to the TRY amount of the withholding tax levied on the PPI distributions and which provides for a sum to paid (received) by Counterparty on any depreciation (appreciation) of TRY against EUR from inception to the next distribution payment date. Alternatively, Milan Branch may enter into a independent hedging arrangement with the market.

LuxParent Forward

- 36. At the same time that the PPI is issued to the Milan Branch (an issuance which has been approved by LuxParent), LuxParent enters into an agreement to forward purchase the PPI (or PPI issued by LuxSub on similar terms) (the "LuxParent Forward") from BarSub.
- 37. The LuxParent Forward can be accelerated by either party. In any situation in which there is an early unwind, the LuxParent Forward will be accelerated and the PPI ultimately redeemed. Where there is an early unwind before a distribution payment date the Counterparty Repo and CCS will also be accelerated.
- 38. The forward sale will be at the TRY par value of the PPI with ongoing flows under which LuxParent pays 'i' and BarSub pays 'ND';

Where:

i = TRY Libor - [adjustment].

ND = the amount of distributions under the PPI net of Luxembourg WHT.

39. The adjustment to the payment of 'i' will be equal to Barclays benefit from the transaction.

BarSub Warrant

- 40. BarSub will be granted an American style warrant ("**BarSub Warrant**") by LuxSub giving it the right but not an obligation to subscribe at fair market value for PPI, identical in their terms to those issued by LuxSub to the Milan Branch. The BarSub Warrant will be exercisable at any time up to the maturity or shortly thereafter of the last repo transaction entered into with the Counterparty over the relevant PPI. The granting of the Warrant will require the consent of LuxParent.
- 41. It is envisaged that BarSub will exercise the BarSub Warrant in order that it be able to satisfy its obligation to deliver the PPI under the LuxParent Forward.

Collateral

42. Should collateral be required by the Counterparty for entering into the Counterparty Repo, Milan Branch will use the amounts otherwise invested in the Milan Branch EUR Deposit to enter into a reverse repo with Head Office over suitable securities (e.g., OECD Government securities) and charge these assets to the Counterparty. Head Office will use the amounts received from Milan Branch to make a back to back reverse repo with the market.

Transaction Timing and Structuring

- 43. The Counterparty's usage of tax capacity is variable with movements in TRY Libor.
- 44. This is because the Counterparty receives largely exempt distributions on the PPI and has a deductible expense on the CCS, both of which are linked to TRY Libor.
- 45. In order to address the variability of capacity usage, it is intended that there should be flexibility in the notional size of the transaction over time. The actual arrangements will be subject to discussions with the counterparties as to their preferences, however potential arrangements include:
 - 45.1. Dividing the total principal amount of the PPI into a number of tranches, with a 3-month roll date. Therefore at any given roll date Counterparty would have the option to roll the Counterparty Repo over only some of the PPI issued at the inception of the transaction. Were this to happen, the PPI tranches which were not repoed on a given roll date would

be sold to LuxParent under an acceleration of the relevant forward sale and ultimately redeemed. As such, were TRY Libor to increase, Counterparty would have the option to roll the Counterparty Repo over a smaller number of Genussschein tranches than that issued at inception. Likewise, should TRY Libor decrease, Counterparty would have the option to roll the Counterparty Repo over a great number of PPI tranches than that issued at inception. New tranches would be issued by LuxSub to enable this.

- 45.2. Structuring the transaction on a 12 month basis, but adding early repurchase rights that can be effected by either party (subject to the CCY/EUR exchange rate being outside of a specified range) where any early repurchase may (at the election of the Holder under the terms of the PPI) trigger a distribution under the PPI (such that the transfer can be made on a 'clean' basis) at the option of the Counterparty.
- 46. Depending on the selected approach, the other transaction arrangements will have to be amended accordingly. For instance, the Counterparty Repo may take the form of a 12 month master agreement and including provision for repeat repo transactions with a term equal to the period from one dividend payment date to the next (or in the case of the first roll from issuance to the first dividend payment date). The LuxParent Forward may be tranched, with the possibility to effect the forward sale on the individual PPI tranches issued by LuxSub.
- 47. In any event, LuxSub will establish a programme under which it can issue tranches of PPI to enable new issues via a issue/pricing supplement and new subscription agreement.

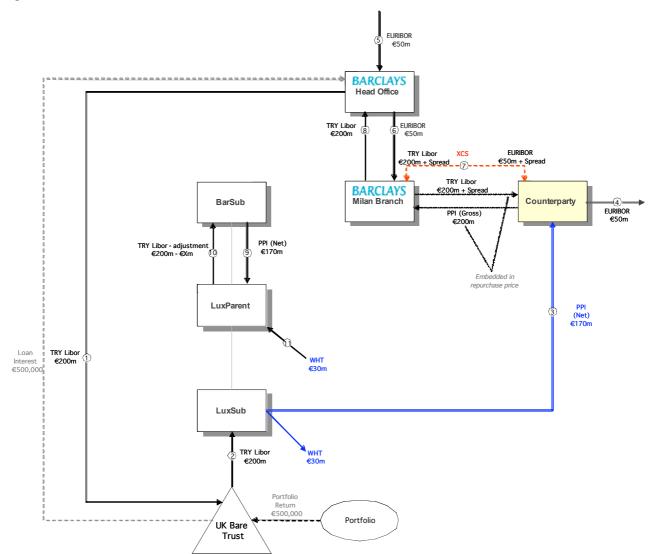
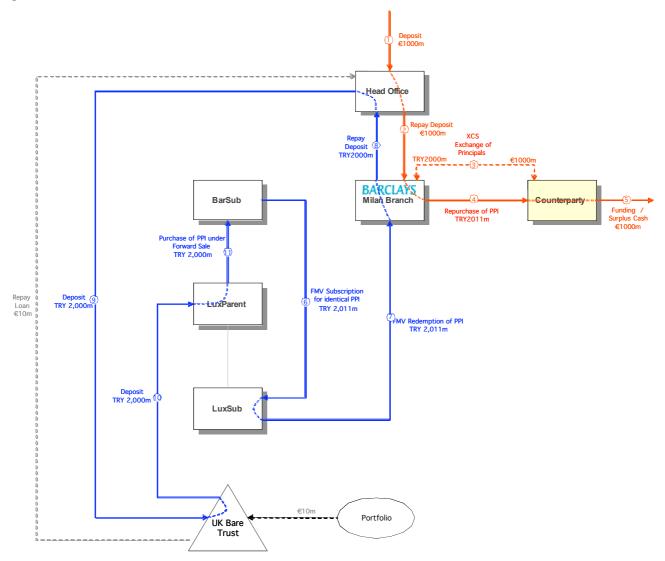


Figure 2 :Interim Flows

Numbers are in euros and calculated on an annual basis:

- 48. LuxSub receives €[200]m from Head Office as TRY Libor interest on the Barclays TRY Deposit via the Trust.
- 49. LuxSub uses the €[200]m interest from the Barclays TRY Deposit to make a distribution on the PPI of €[200]m. This payment to the Counterparty is subject to Luxembourg withholding tax at a 15% rate, resulting in a net distribution of €[170]m. The withholding tax amount is paid to the Luxembourg tax authorities. A certificate setting out the amount of withholding tax paid will be stamped by the Luxembourg tax authorities and provided to Counterparty in accordance with the terms of the PPI. The certificate will identify the Holder as the recipient of the distribution made under the PPI.
- 50. Milan Branch pays the Counterparty €[50]m representative of Euribor interest and receives €[200]m representative of TRY Libor under the CCS (excluding spreads).
- 51. Milan Branch pays Head Office €[200]m interest due on the Milan Branch TRY Deposit and receives €[50]m interest on the Milan Branch EUR Deposit.
- 52. Head Office receives €[50]m interest on the Market EUR Deposit.
- 53. BarSub pays amounts representative of net PPI distributions to LuxParent and receives TRY Libor interest less adjustment under the LuxParent Forward.
- 54. The return from the Portfolio will be swapped into 3 month Euribor and used to service the interest on the €[10]m loan made by Head Office.

Figure 3 : Unwind



- 55. Head Office will be repaid the Market EUR Deposit and will use the funds received to return the Milan Branch EUR Deposit to Milan Branch.
- 56. Milan Branch will swap the €[1,000]m received from Head Office with Counterparty for TRY[2,000]m as a Final Exchange of principals under the CCS.
- 57. Milan Branch will use the TRY[2,000]m received and an additional overdraft facility to repurchase the PPI from the Counterparty for the repurchase price which is envisaged to be TRY[2,011] ⁸m under the Counterparty Repo.
- 58. BarSub will exercise the BarSub Warrant and use an overdraft facility to subscribe at fair market value for PPI identical to those issued by LuxSub to the Milan Branch. This amount will include any applicable spread, with BBPLC Head Office acting as calculation agent.
- 59. Using the proceeds of the subscription under the BarSub Warrant, LuxSub will redeem the PPI issued to the Milan Branch for fair market value which, for the purposes of this paper, is assumed to be TRY[2,011]m. In practice the fair market value will be determined by the calculation agent, acting in good faith, in order to identify acceptable bid-offer pricing levels for the PPI. The calculation agent will be BBPLC.

⁸ Calculated in accordance with the repurchase price formula: Repurchase price = P + i – GD = TRY[2,000]m + TRY[400]m + TRY[11]m (Spread) – TRY[400]m (GD)

- 60. Milan Branch uses the proceeds of the redemption of the PPI to repay the Milan Branch TRY Deposit (and settle the balance of any overdraft raised).
- 61. Head Office returns the Barclays TRY Deposit to LuxSub, the funds being transferred directly to the Trust and makes an additional loan, should it be required, to LuxParent equal in amount to the shortfall (if any) between the fee received and the amount of withholding tax levied on the PPI distributions made by LuxSub.
- 62. The Trust, acting on behalf of LuxSub, makes a deposit of TRY[2,000]m with LuxParent (the "LuxSub TRY Deposit").
- 63. LuxParent pays the forward sale price under the LuxParent Forward of TRY[2,000]m to BarSub.
- 64. As a result of the LuxParent Forward, LuxParent is recognised as the owner of the PPI for Luxembourg domestic tax purposes. Any loan advanced by Head Office will be repaid once credit/reimbursement in respect of the prepaid corporation tax which LuxParent is treated as having borne ("Credit/Reimbursement") is received from the Luxembourg Tax Authorities (see para 112).
- 65. As a result of the steps above LuxParent has a TRY[2,000]m liability in the form of the LuxSub TRY Deposit and a TRY[2,000]m asset in the form of the PPI it now holds after settlement of the LuxParent Forward. LuxSub has an equal and opposite position.
- 66. The remaining internal positions can be unwound by LuxParent returning the LuxSub TRY Deposit and LuxSub redeeming the PPI. It is expected that the redemption amounts payable under each of these arrangements will be equal, and can be netted off.

ECONOMICS AND ECONOMIC DRIVERS

Summary Economics

<u>Counterpa</u> rty				
	Pre Tax	Та	ix Po	ost Tax
Genusscheine Receipt	€185,9	67,247	(€3,068,460)	€182,898,78
XCS TRY Libor Leg	(€185,9	67,247)	€61,369,191	(€124,598,05
XCS Euribor Leg	€50,0	00,000	(€16,500,000)	€33,500,00
Funding Cost	(€50,0	00,000)	€16,500,000	(€33,500,00
Spread on Counterparty Repo	€5,2	99,888	(€1,748,963)	€3,550,92
Non-Recoverable WHT			(€26,500,333)	
	€5,2	99,888	€30,051,436	€35,351,32
Counterparty PTE	€52,7	<mark>63,17</mark> 1		
<u>Barclays Consolid</u> ated				

<u></u> area				
	Pre Tax	Та	ix Po	ost Tax
TRY Libor Expense	(€185,9	967,247)	€55,790,174	€130,177,07
Euro Deposit Interest	€50,0	000,000	(€15,000,000)	(€35,000,00
XCS TRY Libor Leg XCS Euribor Leg		,	(€55,790,174) €15,000,000	
Fee		595,199		€15,816,63
	€22,	595,199	(€6,778,560)	€15,816,63
Barclays PTE	€22,	<mark>595,19</mark> 9		

For the example above we have made the following assumptions:

- The calculations above assume a 12 month transaction.
- A TRY swap rate of 20% is used as a basis for the calculation of benefit.
- The benefit is calculated using TRY:EUR forward exchange rates assuming quarterly payments under the Genussschein.
- Note that the SCM benefit is in TRY and therefore subject to fluctuation in the absence of entering into a forward with the counterparty or other hedging arrangement, which could result in the benefit being a known amount of Euros.
- There is no requirement for short-term funding (and thus no costs) associated with the credit/reimbursement of prepaid Luxembourg corporation tax, this is because on the basis of the numbers presented in the table, the fee received will be larger than the short-term shortfall.

TAX ANALYSIS

UK Tax Analysis

The UK treatment has been discussed with Slaughter and May and will be confirmed in an opinion which will follow.

BBPLC (Milan Branch)

67. The PPI, which is a debt agreement under civil law, should be a loan relationship within the meaning of s.81 FA 1996. This is on the basis that there is a creditor and debtor in relation to a money debt and there is a transaction for the lending of money.

- 68. The PPI will be a connected party loan relationship and thus taxed on an amortised cost basis. Exchange gains and losses will be brought into account under s.84A FA 1996.
- 69. Since Milan Branch initially subscribed for the PPI, subsequently sells the instrument and ultimately repurchases it under the Counterparty Repo, the Counterparty Repo should qualify as a repo falling within section 730A ICTA 1988 and s.737A-C ICTA 1988. The repo which is expected to have a repurchase price equal to par plus a small spread factors in interest and manufactured overseas dividends ("**MODs**"), which will be deemed to be paid for UK tax purposes under s.737A ICTA 1988. The MODs are fully taxable and the interest and spread is relievable as an increase to the repurchase leg.
- 70. As the spot sale and forward purchase are in TRY, s.730BB ICTA 1988 applies and brings into accounts exchange gains or losses under the loan relationships regime (s.730BB(6)).
- 71. One technical point which arises on repo transactions involving loan relationships is the interaction of s.97 FA 1996 and paragraph 15 Schedule 9 FA 1996. The latter provision treats the repo spot seller as continuing to be party to the loan relationship (and hence presumably accruing income on that loan relationship), but s.97 also deems manufactured interest received by the spot seller to be interest on a loan relationship. In practice, this point obviously arises on all repos of debt instruments, and does not appear to give rise to any double taxation on the same income. The basis for this sensible approach seems to be that there is still only one item of income in the seller's accounts.
- 72. There is no reverse charge in respect of the MOD on the basis that the PPI are loan relationships, and therefore reg 2B of the SI 1993/2004 (MOD Regs) applies.
- 73. Any profit or loss on redemption of the PPI will be brought into account in accordance with the loan relationship rules under FA 1996.
- 74. The CCS is a derivative contract within the meaning of the Schedule 26 FA 2002, with debits and credits brought into account in line with the accounts.

BBPLC (Head Office)

- 75. The LuxSub Deposit will be connected party loan relationship and taxed on an amortised cost basis. Exchange gains and losses will be brought into account under s.84A FA 1996.
- 76. The Market Deposit will be taxed as a loan relationship under FA 1996 in line with the accounting treatment.

BarSub

- 77. There are potentially different analyses of the Forward Sale over the PPI (which has an embedded Coupon Swap). On the one hand, the Forward Sale is a related transaction under s.84 FA 1996, such that profits and losses arising from the agreement should be brought into account under the loan relationship rules. Under this approach, the receipts and payments under the Coupon Swap would be viewed as income and expense incurred in the disposal of a loan relationship. If the TRY payments were dis-embedded from the purchase price and paid separately under the Forward by BarSub, they could alternatively be treated as manufactured interest payments under s.97 FA 1996.
- 78. On the other hand, if and to the extent that the above payments are not brought into account under the FA 1996 regime, the Forward Sale could be analysed as a derivative contract governed by Schedule 26 FA 2002. Under this approach the tax treatment would again follow the accounting position.

79. Whether the receipts and payments under the Forward Sale are brought into account under the loan relationships regime, the derivative contracts regime or both (it seems possible for the loan relationships regime to apply to one leg of the Coupon Swap and for the derivative contracts regime to apply to the other leg), the overall result should be that the Forward and Coupon Swap should be taxed in accordance with BarSub's accounting treatment.

LuxParent

- 80. The discussion below is premised on the basis that LuxParent's position must be analysed on the basis that it is UK tax resident (based on the CFC assumptions in Schedule 24 ICTA 1988)
- 81. Depending on the analysis adopted for BarSub in respect of the Forward and Coupon Swap, LuxParent will have a symmetrical position (taxed under the loan relationship regime and/or the derivative contract regime).
- 82. LuxParent will also obtain a Credit/Reimbursement for an amount equal to the Luxembourg WHT paid by LuxSub in respect payments on the PPI.
- 83. The net position for LuxParent should be flat (before any spread) as a result of the expense under the Coupon Swap and the receipt together with tax Credit/Reimbursement (assuming the latter is taxable).
- 84. It is envisaged that LuxParent would pursue an ADP.
- 85. In any event, there is no motive to divert profits from the UK.

LuxSub

- 86. Under the assumption that LuxSub is UK tax resident, LuxSub earns interest income on the Barclays Deposit (via the bare trust) and accrues an expense on the Genusschiene (a loan relationship). As such, LuxSub should be flat from a tax perspective having an equal and opposite income and expense item.
- 87. It is envisaged that LuxSub would pursue an ADP.
- 88. In any event, there is no motive to divert profits from the UK.

Treasury Consent/Notification

- 89. As the General Consents do not apply to all the transactions which are contemplated, notification under s.765A ICTA 1988 will be required. Specifically:
 - 89.1. Issue of PPI. The General Consents should apply as the issue is to BBPLC for full consideration (para 3(b)(ii);
 - 89.2. Barclays TRY Deposit. No debenture is created/issued by a non-UK resident;
 - 89.3. Transfer of PPI by Milan Branch to BarSub. The General Consents should apply as the transfer is between members of the UK resident group; and
 - 89.4. Transfer of PPI to LuxParent by BarSub; the General Consents do not apply.

Italian Tax Analysis

The expected treatment has been discussed and agreed with Freshfields Milan and has been confirmed in an opinion which is attached herein (see Appendix [3]).

Counterparty

- 90. The Counterparty is subject to both IRES (the Corporate Income Tax) at 33% and IRAP (the Regional Tax on Productive Activities) at 4.25%.
- 91. Subject to the next sentence, the Italian tax treatment of securities acquired under a repo ("riporto") or a sale and repurchase agreement ("pronti contro termine") is consistent with the accounting treatment: it does not represent the acquisition/disposal of the instrument and would not trigger capital gains/losses for the Counterparty. However, under Italian tax law the spot buyer is treated as the owner of any *income* received in respect of securities acquired under a Repo. This principle has been reaffirmed by a provision of law recently enacted (Art. 2(19) of Law Decree 3/10/06 n. 262, converted into law by Law 24/11/06 n. 286).
- 92. The PPI qualify as instruments "comparable to shares" pursuant to art. 44(2) of Decree 917/86 and will therefore benefit from the 95% exemption accorded by Art 89(3) of Decree 917/86.
- 93. Under Art 2(19) Law Decree 3/10/06 n. 262 an Italian resident tax payer which acquires foreign equity securities under a repo can rely on the 95% exemption from IRES if the spot seller could have claimed the 95% exemption had it not disposed of the equity instrument in the form of a repurchase agreement. In this case Counterparty should benefit from the 95% exemption because Milan Branch would have been able to claim the 95% exemption had it held the PPI.
- 94. The deductibility of funding costs and any currency translation loss in relation to the repo (which may arise where the repo is denominated in a currency other than Euros) should not be impaired by the various provisions which have been recently enacted to limit the deductibility of costs and expenses.
- 95. Should the Counterparty enter into a currency swap to hedge the currency exposure arising from the Counterparty Repo against Euro, any currency gains/losses realised thereon should be taxable/deductible for Italian tax purpose pursuant to the same rules which apply to the gains/losses realised on the hedged asset (repo).
- 96. No Italian withholding tax should be levied on the flows exchanged by Milan Branch and the Counterparty under the currency swap. Should Milan Branch enter into a similar currency swap with head office, no Italian withholding tax should be imposed on the flows thereof.
- 97. A foreign tax credit for the Counterparty should be available to the extent to which the distributions on the PPI are included in determining the taxable income of the Counterparty for IRES purposes (i.e. 5% of the gross distributions).

Milan Branch

- 98. Milan Branch, being the Italian permanent establishment of a foreign company, is liable to both IRES (levied at the rate of 33%) and IRAP (levied at the basic rate of 4.25%, with possible regional surcharges of up to an additional 1%) as Italian resident corporations.
- 99. For Italian corporate income tax purposes, the taxable profit of the branch must be determined on the basis of specific profit and loss accounts (IAS/IFRS).
- 100. The PPI will be shown as an asset and the Counterparty Repo will be reflected as a liability in the branch accounts. In the profit and loss of the branch, the distributions on the PPI are accounted as a positive item of income and the repo return (being the algebraic sum of repo price differential less the distributions on the PPI) among costs and expenses. In the Branches tax computation, an adjustment will be made to ensure that the dividends are not subject to tax in the hands of the Milan Branch corresponding to the principle in paragraph 91. Upon transfer or redemption of the PPI at maturity of the transaction, gains/losses will be taxable/relievable at the level of Milan Branch.

- 101. Any gains/losses arising from the currency swaps entered into by the Milan Branch with the Counterparty and its head office will be taxable/deductible for Italian tax purposes.
- 102. Should there be any transfer or redemption of the PPI in the hands of Milan Branch in exchange for the payment of its market value, Milan Branch should be exempt from Italian transfer tax (since this would be a transaction between a non-resident subject and a subject formally authorised to carry out investment services in Italy).
- 103. The Counterparty Repo should not be subject to transfer tax, VAT, nor imposta di registro (stamp duty) provided that the agreement is executed outside the territory of Italy, or by way of exchange of letters.

Anti Avoidance

104. It should not be possible to challenge the transaction under discussion under article 37-bis of Decree 600/73 since the transaction should be based upon valid economic reasons: the Counterparty obtains an economic return before considering any tax element associated to trade which is higher than return available for comparable transactions and in any case material compared to the tax benefit at stake.

Luxembourg Tax Analysis

Corporate Income Tax

- 105. LuxParent should be regarded for Luxembourg purposes as the beneficial owner of the PPI in LuxSub if certain conditions are met, the most important of which is that the LuxParent Hedge will attribute sufficient control, risk and rewards over the PPI to LuxParent. LuxParent should be treated as entitled to and taxable on the gross PPI distribution.
- 106. LuxSub should be treated as earning exempt income as a result of the income deriving from a permanent establishment for Luxembourg purposes (UK Bare Trust).
- 107. The withholding tax on the PPI is required under Luxembourg tax law as a withholding tax on the payment of a distribution on a securitised profit participation instrument

Net Wealth Tax

- 108. From a Luxembourg tax perspective, neither LuxParent nor LuxSub should have any net assets subject to net wealth tax.
- 109. LuxSub has no net wealth tax base because the permanent establishment is respected for net wealth tax purposes (i.e., the exemption from corporate income tax is followed for net wealth tax purposes).

Capital Duty

- 110. Capital duty will be due and paid on the creation of LuxParent and LuxSub
- 111. No capital duty should be due on the issue of the PPI.

Credit/Reimbursement

112. Any Credit/Reimbursement due would be paid to LuxParent following the finalisation of LuxParent's tax assessment in accordance with Luxembourg law. It is currently envisaged that a reimbursement would be available within two months of the end of LuxParent's accounting period. We are currently also exploring the possibility of receiving reimbursements on the basis of anticipated filings, i.e. accelerated reimbursements within two months of each underlying periodic withholding tax payment in connection with payments under the Instrument .

Tax Capacity

- 113. Project Brontos does not require the use of UK tax capacity.
- 114. The transaction does not require any Luxembourg capacity. The Luxembourg WHT paid by LuxSub should be treated as a prepayment of corporation tax at the level of LuxParent. This is on the basis that LuxParent should be beneficially entitled to the coupon paid by LuxSub from a Luxembourg tax

perspective and hence is treated as having borne the WHT. On the basis that LuxParent has net taxable income equal to the spread paid to LuxParent, the prepayment (less an amount representing tax on the spread) is expected to be refunded shortly after the assessment period is closed. Consequently, this transaction does not require any Luxembourg tax capacity.

115. Overall the only tax capacity usage is by the Counterparty in Italy.

TAX RISK

Luxembourg Tax

- 116. The Luxembourg tax treatment will be confirmed in a ruling from the Tax Inspector. The ruling is a confirmation of the application and interpretation of the law as its stands. Rulings are binding on the basis of the principle of "good faith" in Luxembourg law and are not limited to tax law. The effect of this principle is that where a taxpayer has relied on a ruling, the tax treatment which the ruling confirmed is applied by the tax administration. The principle of good faith is specifically included in the Abgabenordnung (Tax Administration Law) and has been confirmed in several court decisions in other areas of law.
- 117. The rulings are binding where the taxpayer (i) submits a written request, (ii) discloses all relevant facts, (iii) transacts in accordance with the facts set out in the disclosure, and the (iv) law remains current. On the basis that these conditions are met, the ruling obtained in relation to the Brontos structure is binding.
- 118. The tax reimbursement itself would not be subject to a ruling from the Luxembourg Tax Inspector, but it is expected that the Inspector would confirm that all relevant tax and administrative provisions which are relevant to obtaining a timely reimbursement are applicable to the facts set out before the Inspector. This confirmation would have the aim of providing comfort that the reimbursement, and its timing, would be made in line with our expectations.
- 119. SCM will ensure that the reimbursement due from the Luxembourg Tax Authorities does not exceed €[150]m at any one time.

UK Tax

120. The only UK tax risk is the risk that LuxParent and LuxSub could be treated as CFCs. This is considered to be a very small risk on the basis that both companies will pursue ADPs and in any event, there is no motive to divert profits from the UK.

Italian Tax

121. As described in paragraph 34, Barclays will represent that the payments under the PPI would benefit from the Italian tax exemption in the hands of Milan Branch were they to be received by the Branch, i.e. had Milan Branch not transferred the PPI under the Repo. The Counterparties' benefit is dependent on the repo seller (Milan Branch) being able to satisfy this condition. As such, Barclays would indemnify the Counterparties for any loss of benefit as consequence of the representation not being satisfied. The potential risk to Barclays of the representation is €[52.8]m per annum per €[1,000]m investment for the Unicredito trade and €[14.2]m per annum per €[1,000]m investment for the Unicredito trade and €[14.2]m per annum per €[1,000]m investment for the trade). It is envisaged that the transaction with Unicredito would involve an investment of up to €[2,500]m, and the transaction with Intesa would involve an investment of up to €[1,000]m.

ACCOUNTING

122. The analysis below in respect of the solus accounts of BarSub, BBPLC and the consolidated accounts of BBPLC has been confirmed with SCM Finance. LuxParent and LuxSub accounting has been confirmed with KPMG Luxembourg and will be agreed with PwC in Luxembourg.

IFRS

Milan Branch (branch books and records)

123. The PPI will be accounted for as a loan and receivable under the heading 'Amounts owed from Group undertakings' and accounted for at amortised cost.

- 124. The Milan Branch TRY Deposit will be accounted for as a liability under the heading 'Amounts owed to Group' and accounted for at amortised cost.
- 125. The Counterparty Repo will be accounted for as a deposit from the counterparty under the heading 'Deposits from banks' and measured at amortised cost.
- 126. The Barclays EUR Deposit will be accounted for as an asset under the heading 'Amounts due from Group undertakings' and accounted for at amortised cost.
- 127. The CCS will be recorded as a derivative and fair valued through the profit and loss account.
- 128. Foreign exchange gains and losses on the assets and liabilities listed above, that are denominated in TRY, will be recorded in the profit and loss account.

SCM (books and records)

- 129. The Milan Branch TRY Deposit will be accounted for as an asset under the heading 'Amounts due from Group' and accounted for at amortised cost.
- 130. The Barclays EUR Deposit will be accounted for as a liability under the heading 'Amounts due to Group' and accounted for at amortised cost.
- 131. The Barclays TRY Deposit will be recorded as a liability under the heading 'Amounts owed to Group undertakings' and accounted for at amortised cost.
- 132. The Market EUR Deposit will be accounted for as an asset under the heading 'Loans and Receivables' and accounted for at amortised cost.
- 133. The £10m loan to LuxSub, funding the Portfolio will be accounted for as a loan and receivable under the heading 'Amounts owed from Group undertakings' and accounted for at amortised cost.
- 134. The TRS will be accounted for a derivative and marked to market.

Solus Accounts – BBPLC

- 135. The Barclays TRY Deposit will be recorded as a liability under the heading 'Amounts owed to Group undertakings' and accounted for at amortised cost.
- 136. The Market EUR Deposit will be accounted for as an asset under the heading 'Loans and Receivables' and accounted for at amortised cost.
- 137. The PPI will be accounted for as a loan and receivable under the heading 'Amounts owed from Group undertakings' and accounted for at amortised cost.
- 138. The £10m loan to LuxSub, funding the Portfolio will be accounted for as a loan and receivable under the heading 'Amounts owed from Group undertakings' and accounted for at amortised cost.
- 139. The TRS will be accounted for a derivative and marked to market.
- 140. The Milan Branch TRY Deposit and the Milan Branch EUR Deposit will eliminate on integration of the Milan Branch and Head Office.

Solus Accounts – BarSub

141. The LuxParent Forward will be a derivative contract which is fair valued through the profit and loss account.

Luxembourg GAAP

142. Under Luxembourg law, non-listed Luxembourg companies are permitted to prepare accounts only under Luxembourg GAAP. (It is only possible to depart from this by special agreement with all relevant Luxembourg authorities, e.g. regulators, tax authority). The following accounting summary has been provided by KPMG Luxembourg and has been prepared under Luxembourg GAAP and on the basis that LuxParent and LuxSub have Euro functional currencies. The KPMG accounting analysis will be reviewed by PwC prior to execution of the transaction.

Solus Accounts – LuxParent

143. LuxParent will show the LuxParent Forward as a derivative and will recognise the mark-to-market movements in the profit and loss account reflecting payments on the PPI and TRY Libor payments due to BarSub.

Solus Accounts – LuxSub

- 144. Since the primary asset and liability of LuxSub are in TRY, it is likely that the functional currency of LuxSub for Luxembourg GAAP purposes will be TRY.
- 145. The Barclays TRY Deposit will be recorded as an asset and accounted for at amortised cost.
- 146. The Portfolio will be recorded a liability; either as 'Loans and Receivables' or if the assets are securities, 'Treasury Bills' or 'Debt Securities'. Interest income under the Portfolio will be accrued in the profit and loss account.
- 147. The TRS will be accounted for a derivative and marked to market.
- 148. The PPI will be shown as debt liability with expenses reflected in the profit and loss account.
- 149. If, contrary to paragraph 144, LuxSub has a Euro functional currency, specific rules dealing with foreign exchange translations will apply. Luxembourg GAAP has specific rules dealing with value adjustments (e.g. foreign exchange translations etc) in respect of principal amounts. The general principle is that losses are recognised in the P&L when they are probable, but gains are only shown in the P&L when they are certain. As a result, LuxSub discloses any downward value adjustments linked to the TRY. The corresponding value adjustment on the PPI or TRY Deposit is an unrealised gain which has no P&L impact on the basis that the gain is not certain and could unwind during the life of the TRY Deposit.

BBPLC Consolidated Accounts

- 150. For consolidation purposes LuxParent and LuxSub will have EUR functional currencies being an extension of SCM's European business.
- 151. BarSub, LuxParent and LuxSub will be consolidated by BBPLC as they are wholly owned and controlled by BBPLC, and BBPLC is exposed to the risk and rewards of the entities. They will be consolidated under IAS27.
- 152. On a consolidated basis the only external items to Barclays group are the:
 - 152.1. Counterparty Repo which will be accounted for at amortised cost as a liability under the heading 'Deposits from banks'. The fee receivable from the counterparty will be included in the effective yield in repo (adjustment to repo rate), i.e. accrued over the term of the repo;
 - 152.2. Market EUR Deposit which will be accounted for as an asset under the heading 'Loans and Receivables' and accounted for at amortised cost; and
 - 152.3. CCS which will be fair valued through the profit and loss account.
 - 152.4. The Portfolio will be recorded a liability; either as 'Loans and Receivables' or if the assets are securities, 'Treasury Bills' or 'Debt Securities'. Interest income under the Portfolio will be accrued in the profit and loss account.
- 153. Overall, Barclays obtains sub-libor funding from Counterparty shown as a sub libor spread on the Repo.

Counterparty Accounting

154. We understand that counterparties would show the transaction as a secured lending (i.e., deposit with Barclays) under IFRS. Standard interagency representations and warranties (including accounting treatment) will be agreed between the parties.

REGULATORY CAPITAL

Current Arrangements (Basel I)

- 155. On a solus and consolidated basis the transaction will use WRAs on the CCS which are equal to the counterparty risk weighting of 20% multiplied by of the sum of (i) [1]% of the Notional Amount plus (ii) any positive mark-to-market WRAs.
- 156. Any additional equity funding of BarSub from BBPLC, in order for BarSub to establish LuxParent will be a deduction from capital. The amount of any additional equity funding is expected to not exceed €[25,000].
- 157. The subscription for the PPI by BBPLC (Milan Branch) will create an internal large exposure which will be mitigated by legal set off against the Barclays TRY Deposit. The set off will be by way of a side letter between BBPLC and LuxSub.

Basel II

158. WRAs and exposure on CCS at the solus level will be subject to model in respect of risk weighting and exposure measurement (EPE).

CREDIT

159. Barclays is not expected to take credit risk on the Counterparty under this transaction. However, it may have settlement risk to Counterparty for the return paid under the PPI.

CLIENT ENGAGEMENT

Unicredito

- 160. The following staff of Unicredito have been engaged in the origination process to date:
 - Ranieri De Marchis (CFO)
 - Luciano Tuzzi (Deputy CFO)
 - Stefano Porro (Head of SCM)
 - Nicola Gerundino (SCM)
 - Patrizio Braccioni (Head of Tax).

Intesa

- 161. The following staff of Intesa have been engaged in the origination process to date:
 - Enea Saldarini (Head of SCM)
 - Federico Manna (SCM)
 - Giovanni Carpenzano (Head of Tax)

MATERIALITY OF PROPOSED TRANSACTION

- 162. The proposed transactions with Unicredito and Intesa, would involve investments by the Counterparty of up to €[2,500]m and €[1,000]m respectively.
- 163. The tables below summarise key financial data for each potential counterparty.

Unicredito

Increase in Pre-Tax Income*	€ 14.25m
Total Tax Cashflow*	€ 152.0m
2005 PBT (UniCredito Group)	€ 5,603m
2005 taxes (UniCredito Group)	€ 1,719m
2005 Net Income (UniCredito Group)	€ 3,884m
Total assets as at 31 Dec 2005 (UniCredito Group)	€ 787,000m
Aggregate of share capital + reserves + net profit (UniCredito Group)	€ 39,300m

Intesa

Increase in Pre-Tax Income*	€ 1.4m
Total Tax Cashflow*	€ 15.2m
2005 PBT**	€6,751m
2005 taxes**	€ 1,843m
2005 Net Income**	€ 4,902m
Total assets as at 31 Dec 2005	€ 534,379m
Aggregate of share capital + reserves + net profit	€ 51,674m

* Based on a 12 month trade.

** 2005 numbers refer to the aggregated results of Banca Intesa S.p.A and Sanpaolo IMI S.p.A. (both having reported separately for the year ended 31 December 2005).

PROVISION

164. SCM proposes a nil provision on the basis that there is no material UK or Italian tax risk, and the Luxembourg tax analysis will be ruled in advance of any transaction.

Enclosures

Appendix 1: Background Information

Appendix 2: Draft Italian Tax Opinion (Freshfields Milan)

Appendix 1: Background Information

Profit Participating Instrument

The PPI will have the following key features:

- 1.1. The PPI will be issued in the form of a Genussschein. Genussschein are classified as debt instruments under civil law but can qualify as equity for tax purposes in both Italy and Luxembourg.
- 1.2. The PPI holder will be entitled to a return that is equal to a proportion of the Issuer's "profits" available, as defined in the PPI and subject to a cap which will be equal to a TRY Libor return on the principal amount of the PPI, for a maturity which corresponds to the frequency of the payment dates. The issuer is entitled to make advance payment on a quarterly or semi-annual basis. Should the amounts paid in this way exceed the profit determined in the issuer's annual accounts the issuer will be entitled to a rebate.
- 1.3. In the event of liquidation or early termination, the PPI holder participates in the good-will and hidden reserves of the issuer accumulated during the term of the instrument in the form of a redemption premium (or discount).
- 1.4. The PPI will be documented as a freely transferable, registered instrument.
- 1.5. In cases where the holder and issuer of the PPI are in the same accounting group the terms of the PPI will allow for the PPI to be redeemed by mutual agreement of the issuer and holder at fair market value.
- 1.6. The issue amount of the PPI does not form part of the share capital of the issuer.
- 1.7. The PPI holder has no shareholder rights, in particular the PPI holder has no management, control, information or voting rights.
- 1.8. LuxSub will enter into a separate agreement with LuxParent under which LuxSub must seek written consent from LuxParent before any issuance or transfer of PPI.
- 1.9. The issuer of the PPI is permitted to use the proceeds to make investments, either directly or indirectly by entering into agency, nominee or trust arrangements. The Issuer will obtain income from entities which (1) are resident in EU member states (as at the date of the issue of the Profit Participating Instrument), and (2) which benefit from the relevant double tax treaties (i.e., are not excluded entities) and (3) which have a credit rating of at least "AA" by S&P or "Aa2" by Moody's.
- 1.10. Distributions made under the PPI will be non-deductible for Luxembourg Tax purposes (a point which will be covered in a ruling). Issuer will represent such fact to the holder of the PPI.
- 1.11. Any transfer of the PPI will, at the election of the Holder before such transfer, trigger a distribution of the accrued profit.
- 1.12. Issuer will also undertake to provide the holder of the PPI with a certificate setting forth the payment made under the PPI and the withholding taxes withheld from such payment.

UK Bare Trust

- 2. Head Office makes a loan to LuxSub of €[10]m which pays Euribor on a quarterly basis. LuxSub directs Head Office to transfer the funds directly to the Trust which will invest them in accordance with the trust agreement.
 - 2.1. An existing UK tax resident investment company subsidiary of Barclays (likely to be Barafor Limited) will be appointed trustee of the Trust ("**Trustee**").
 - 2.2. The trust agreement will provide for the Trustee to invest up to €[10]m in three or more separate assets (the "**Portfolio**") consisting of:
 - 2.2.1. cash deposits with and securities issued by Barclays; and
 - 2.2.2. OECD government securities rated at least "AA" by S&P or "Aa2" by Moody's; and
 - 2.3. Head Office and LuxSub via the Trust will enter into a Total Return Swap ("**TRS**") under which the LuxSub will swap its return on the portfolio, including any credit events or fluctuations in the value of the portfolio assets, for a [3 month] Euribor return.
 - 2.4. Within the strict investment guidelines the Trustee is able to choose whatever assets, and new assets will be purchased on an approximately guarterly basis.

The Trustee will receive a fee from BBPLC (SCM) of c. €[10,000] per annum for its role as trustee to the Trust. The Trustee will prepare audited Trust accounts.