

Large & Medium Sized Groups

Outline of Proposals for discussion

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Participation Dividends

- New Controlled Companies regime would tax UK company in relation to certain profits arising in a subsidiary
- No UK tax when subsidiary then remits profits as dividends (exemption regime)
- “Ordinary” dividends; paid out of profits subject to the CC regime
- So, some foreign income of a UK parent Co. would be taken out of scope of UK tax



New Controlled Companies (CC) Regime

- Based on income / gains, rather than entity
- Clearer way of applying principles behind the “Exempt Activities Test” in current rules
- Focus on:
 - investment (passive) income, and
 - artificially located active income
- Passive income rules would apply UK-UK



Scope of application

Full rules where a UK company:

- (i) forms part of large/medium enterprise and
- (ii) has a 10% interest in a controlled foreign Co

Passive income rules only if as above but either:

- the controlled company is UK resident, or
- UK company is part of a small business (and then only if profits exceed “Gateway” amount)



Passive/Investment Income

- Dividends
- Interest
- Purchased income streams
- Royalties
- Rents (for use of any property)
- Other income of a similar nature
- Income that is passive in substance, but active in form
- Capital gains on income producing assets, or interchangeable with passive income



Passive Income exemptions

- Active finance income (cf. US rules)
- Intra-group interest income (paid from foreign affiliates' exempt profits)
- Certain intra-group income in a territory
- Incidental income
- Conduit interest income
- Participation dividends



Other mobile income

- Target: artificial separation of profit from activity
- In particular, kinds of active income that would fail Exempt Activities Test, e.g.
 - Intra-group services, including assuming group risks (captive insurance etc.)
 - Group sales (invoice routing etc.)



Key design issues

- Aim is achieve more targeted regime, with precise definitions that will give business certainty.
- Need to get the balance right between definitions that go too wide or not far enough, and ensuring rules will be robust as intended.
- Includes considering what further anti-abuse protection may be needed to underpin rules.



Practicalities

- Income measurement by UK GAAP net of certain expenses incurred in earning the income
- Self assessment, as for existing CFC regime
- Credit for foreign tax
- Compensating adjustments for UK-UK rules (cf. transfer pricing)



Interest Anti-abuse measures

- Interest allocation / general restrictions discussed, but more effective CC rules preferred
- Propose two targeted anti-abuse measures:
 - UK relief capped at worldwide external net finance costs
 - Extension of unallowable purpose rules for loan relationships and derivative contracts



Capping UK net finance costs

- Limit aggregate net borrowing costs of UK members to group's consolidated external borrowing costs
- "Group" comprises UK or foreign parent and all 51% subsidiaries
- UK measure = aggregate net finance costs of all UK members of the group (external and intra-group)
- Worldwide measure = group's consolidated net finance costs (i.e. external only)



Capping UK net finance costs

- Finance costs = interest, discounts, interest element of finance leases, payments under derivative contracts, etc.
- UK measure to be tax based (which largely follow accounts)
- Worldwide measure to be accounts based, but adjusted to match UK measure as much as possible
- Rules to operate on a company by company basis; the effect is to pro-rata any restriction among all UK companies



Unallowable purpose rules

- Extension of existing rules
- Existing main purpose of company test remains
- New additional test where main purpose of scheme or arrangement is to obtain a tax advantage
- Extending the definition of main purpose for both the existing and new leg to include a main benefit test



S765 – Treasury Consents

- More effective CC regime and anti-abuse rules (eg interest proposals) would enable:
- Repeal s765 requirement for pre-transaction consents
- Would formulate new information requirement, to inform “real time” risk assessment

