

Part IIIA: Controlled Foreign Company (CFC) interim improvements

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Introduction

1.1 Reform of the UK's Controlled Foreign Company (CFC) rules is frequently identified by UK multinational businesses as the key priority needed to improve the UK's tax competitiveness. The Government announced in the Budget that a new CFC regime would be legislated in Finance Bill 2012, and that as a first step, improvements to the current CFC rules (referred to as 'interim improvements'), would be introduced in Finance Bill 2011.

1.2 The Government does not wish to pre-empt the outcome of consultation on wider corporate tax reforms. As a consequence, the treatment of financing and most situations involving intellectual property (IP) are outside the scope of the interim improvements and will be considered as part of full CFC reform. The current proposals for the treatment of monetary assets and IP as part of full reform are set out in Part II A.

1.3 This Part of the document sets out the package of proposals that the Government will introduce in Finance Bill 2011 to provide improvements to the current rules ahead of full reform.

Principles for reform

1.4 In pursuing this reform the Government will apply the principles set out in the Corporate Tax Road Map published, Part 1 of the Document.

Consultation to date

1.5 This consultation is being conducted in line with the principles outlined in the document "Tax policy making: a new approach" published alongside the Budget. This document sets out three stages for policy development:

- Stage 1 – set out objectives and identify options;
- Stage 2 – determine the best option and develop a framework for implementation, including detailed policy design; and
- Stage 3 – draft legislation to effect the proposed change

1.6 Chapter 2 includes the Government's detailed proposals on the package of interim improvements, which completes stage 2 of the process. The Government will publish draft legislation and an Explanatory Note on 9 December, which is stage 3 of the process. The purpose of the next stage of consultation is to seek views on the draft legislation and the implementation of the proposals.

Next Steps

1.7 Draft legislation and an Explanatory Note will be published on 9 December, alongside other draft clauses of Finance Bill 2011.

1.8 The Government welcomes responses to this consultation and draft clauses by 9 February 2011 in order to allow drafting changes to be made in advance of Finance Bill 2011. Details on how to respond are provided in paragraph 2.36 of this Part of the document.

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Package of CFC interim improvements

Overview of package of CFC interim improvements

2.1 The Government announced in July 2010¹ that the aims of the interim improvements are to:

- modernise aspects of the CFC rules so as to exempt commercially justified activities that both business and HMRC agree do not erode the UK tax base but which could give rise to a CFC charge under the current rules;
- help UK businesses that wish to undertake overseas acquisitions and reorganisations; and
- make other worthwhile improvements suggested during consultation that are consistent with the aims of full CFC reform and do not require disproportionate amendment or revision of existing CFC legislation.

2.2 The Government established a working group of business representatives to help develop the package of interim improvements. Officials have been working with this group, the CFC Liaison Committee² and other advisers and businesses to develop these proposals. Further details on the discussions with the working group and the CFC Liaison Committee are provided in meeting notes (with supporting papers where appropriate) and can be found on the HM Treasury website.³

2.3 The package of interim improvements proposed for Finance Bill 2011 is designed to implement an initial set of changes consistent with the direction the Government has set for full CFC reform. The main change is to exempt a CFC which carries on a range of 'foreign to foreign' activities involving transactions wholly or partly with other group companies provided that there is little or no risk of erosion of the UK tax base. The exemption is designed to produce a proportionate outcome in contrast to the 'all or nothing' approach generally taken by the existing CFC exemptions. The specific changes are as follows:

- an exemption for a CFC carrying on intra-group trading activities where there is minimal connection with the UK and little risk that UK profits have been artificially diverted;
- an exemption for a CFC with a main business of IP exploitation where the IP and the CFC have minimal connection with the UK;
- an exemption which runs for three years for foreign subsidiaries that, as a consequence of a reorganisation or change to UK ownership, come within the scope of the CFC regime for the first time; and
- improve the de minimis exemption and deferral of the withdrawal of the exemption for certain holding companies.

¹ Outlined in the note entitled "Aim and scope of CFC interim improvements" published on 27 July 2010

² A small group of businesses representatives established in April 2009 to discuss CFC reform

³ http://www.hm-treasury.gov.uk/controlled_foreign_companies.htm

2.4 A brief description of these proposed improvements is provided below, with further details set out in Annex A. The draft clauses and explanatory notes will be published on 9 December.

New exemption for certain intra-group activities

2.5 The current CFC rules can affect how UK multinationals structure wholly commercial intra-group trading activities and may lead to a CFC charge in cases involving purely 'foreign to foreign' transactions where there is no risk of artificial diversion of UK profits. To address this issue, the Government is proposing to introduce a new exemption for CFCs that undertake certain intra-group transactions. This exemption, which applies regardless of the proportion of a CFC's transactions that take place with group companies, is aimed at UK multinationals whose CFCs are involved in the provision or consumption of intra-group goods and services, for example as part of a supply chain, and where the transactions do not involve the UK, or do so only to a limited extent. Such arrangements may either be caught by the existing CFC rules or involve disproportionate compliance efforts to establish their exempt status.

2.6 The new exemption should allow UK multinationals to manage overseas operations more efficiently than is possible under the current rules.

2.7 This exemption will be an additional exemption, so a CFC which does not meet its conditions may still meet the conditions of one of the other new or existing exemptions.

2.8 A full exemption will be available for a CFC, if it meets certain conditions in relation to:

- business establishment
- business activities
- amount of finance income and income arising from IP, and
- extent of connection with the UK

Business establishment condition

2.9 The CFC will be required to have a business establishment in its territory of residence. This condition is consistent with existing CFC exemptions (see A.2 in Annex A).

Business activities condition

2.10 The aim is to focus the exemption on trading companies while permitting some flexibility for CFCs with limited investment business. This condition for the new exemption will be satisfied if non-trading activities comprise less than a substantial part of the CFC's business (see A.3 in Annex A).

Finance income and IP condition

2.11 The treatment of finance income (interest and interest-like income) and income from the exploitation of IP are outside the scope of the interim improvements and will be dealt with in full CFC reform. To provide some flexibility, the receipt by a CFC of an incidental amount of total income as finance income or income from IP will not prevent the CFC from qualifying for full exemption (see A.5 in Annex A). To minimise the risk to the UK tax base, it is proposed to adopt a low per cent of total income test of 5%. The Government wants to discuss this with business to determine whether this limit provides sufficient flexibility for the purpose of interims, until the issues of finance income and IP are addressed in full reform.

2.12 If the amount of finance income exceeds this limit, then subject to meeting the other conditions, only the excess will be apportioned to the UK. The exemption provides for this more proportionate approach to determine the CFC charge and will allow a group to assess the profits to be apportioned through an application to HMRC. A CFC with IP income in excess of this limit

is outside the scope of the new exemption, though it may qualify for one of the other new or existing exemptions.

2.13 It is recognised that there may be other circumstances in which greater flexibility would be helpful. An area for further discussion is whether finance income that arises as a necessary incident of the CFC's trading activity, or which is received as an integral part of its trading receipts, might be treated differently from finance income arising from investments.

2.14 A CFC which carries on an insurance business and is part of an insurance group will be subject to the 5% limit on finance income in the same way as any other trading company. The Government understands the integral role that interest plays in the insurance business, and as a part of the discussion mentioned in paragraph 2.13 above, the Government will continue to explore with the industry whether a straightforward and affordable solution can be found as part of the interim improvements or whether this should form part of full CFC reform.

UK business connection condition

2.15 Where a CFC enters into transactions with the UK there is a greater risk of artificial diversion of profit from the UK. But the Government accepts the need to take a proportionate approach depending on the level of such transactions (see A.6 to A.10 of Annex A). The UK business connection condition will therefore be treated as met in full where no more than 10% of the CFCs business income and no more than 10% of the CFC's business expenses are UK income or UK expenses. Where a CFC's business income and expenses are mainly (i.e. more than 50%) UK income and expenses, the CFC will be outside the scope of this exemption but these situations will be considered further as part of full reform.

2.16 Where the proportion of transactions with the UK is between 10% and 50%, a CFC charge may arise unless the CFC falls within a 'safe harbour'.

2.17 The conditions for the safe harbour are that:

- there is an appropriate level of effective management, and
- the CFC's profits fall within a set return on specified operating costs and/or assets.

The 'safe harbour' is designed to reduce compliance costs and increase certainty for CFCs in this position.

2.18 A CFC which does not meet the 'safe harbour' conditions may, by applying to HMRC, agree a reduced CFC charge. The amount of the charge will be determined by first excluding any profits that are fully commensurate with the CFC's economic activity. The remaining profits will then be further reduced to the extent that they arise from non-UK business transactions which do not erode the UK tax base (see A.33 to A.39 of Annex A).

Question 2A: Are the proposed parameters of the relevant conditions of the new exemption an appropriate response at the interim stage whilst still providing adequate protection of the UK tax base?

Question 2B: Is the proposed percentage limit for finance income sufficient and is there a case for providing greater flexibility for finance income that is a necessary incident or which is integral to the CFC's trade?

Question 2C: When considering UK connection, is there a case for distinguishing between transactions with connected parties and those with third parties? Are there circumstances in which third party transactions could be left out of account?

Question 2D: With regard to the 'safe harbour', are there alternative parameters which would be more effective? What might be the most suitable measure of such parameters?

Question 2E: The proposed approach to partial exemption is to ensure that the rules are more targeted, moving away from the all or nothing approach of the current rules. Is the approach suggested workable?

Exploitation of IP with no UK connection

2.19 The treatment of CFCs which receive income from the exploitation of IP is a matter for full reform, but the Government is proposing as part of the interim improvements a limited exemption for a CFC whose main business is to exploit IP. The aim of this change is to allow UK multinationals that hold foreign IP in circumstances that do not pose a risk to the UK tax base to fall outside the CFC rules.

2.20 To qualify, the IP being exploited must have minimal UK connection, and the CFC itself must have minimal UK business connection. The former will be determined by reference to whether the IP has been held or developed in the UK. The latter considers receipts from the UK or expenses incurred on research and development undertaken in the UK, and the nature and extent of any equity funding to determine whether the entity may have been funded from the UK (and hence there may be a risk to the UK tax base) (see A.11 to A.18 of Annex A).

2.21 A CFC which meets the two connection conditions and has minimal finance income will be fully exempt. As for the new intra-group activities exemption, where the minimal finance income limit is exceeded, only the excess income will be apportioned to the UK, with the amount being agreed through application to HMRC.

2.22 While recognising that these are tightly focused conditions, this is intended to be a first step to reduce the impact of the CFC regime on non-UK IP where there is little risk to the UK tax base. Like the intra-group activities exemption, CFCs which meet the conditions for this exemption should be able to manage overseas IP more efficiently than is possible under the current rules. The treatment of IP income under the CFC regime will be addressed fully in the second stage of reform in Finance Bill 2012. The Government's proposals are set out in chapter II A of this document.

Question 2F: Recognising that this IP exemption is intended to be narrow in scope, are there any changes to the design parameters that would make it more useful to business in advance of full reform but which would not increase the risk of UK tax base erosion?

Question 2G: Is the restriction in reference to research and development expenditure in the UK appropriate and is the proposed approach practical? If not, is there another more suitable parameter that could be used?

Temporary exemption following acquisition or reorganisation

2.23 The Government proposes to extend the scope and duration of the temporary exemption from the CFC rules currently provided where a UK multinational newly acquires foreign subsidiaries (often called the period of grace) to assist UK businesses that wish to undertake overseas acquisitions and reorganisations, and non UK businesses that want to invest in the UK (see A19 to A.26 of Annex A).

2.24 Where a UK group takes over an overseas group, it may inherit overseas companies that have not previously been subject to the UK's CFC rules. In such a case, it is unlikely that any of the subsidiaries that become CFC's will have been set up to avoid UK tax. HMRC currently accepts that the motive test exemption is satisfied by such CFCs up to the end of the first full accounting period following the accounting period in which the acquisition occurs. While this approach is designed to allow the UK group time to make any necessary changes to comply with the CFC regime, the Government recognises that it can be challenging for groups to restructure within this time frame and that an additional 12 months would be helpful in this regard.

2.25 The Government will therefore introduce a statutory exemption which runs for a period up to three years for foreign subsidiaries that come within the scope of the CFC regime for the first time as a consequence of a reorganisation or change to UK ownership. The Government is considering whether there are exceptional circumstances in which an application could be made to extend this period beyond 3 years and will consult which businesses in this regard.

2.26 This exemption will apply on a CFC by CFC basis. Unlike the current arrangements, a change in the main business or activities of the CFC will not affect the exemption unless, and to the extent that, it erodes the UK tax base. Where there is such a change, the CFC affected can apply to HMRC to agree a CFC charge which reflects only the profit relating to the change. This will ensure a proportionate response targeted at the risk of artificial diversion from the UK.

2.27 This should provide groups with greater freedom to reorganise in a commercial manner while still being outside the scope of the CFC rules.

2.28 Extending the circumstances in which the period of grace is available, and disregarding wholly commercial changes will provide greater certainty to UK multinationals on an overseas acquisition or restructuring, and to non-UK headed groups considering a move of group or regional headquarters to the UK.

Question 2H: The proposal will include the ability for businesses to apply to HMRC for an extension to the period of temporary exemption, in exceptional circumstances. What genuine reasons would there be for needing such an extension?

Other improvements

2.29 Businesses suggested additional improvements during the consultation process. The focus has been on measures that would benefit the greatest number of businesses without adding additional complexity and remaining consistent with what can be addressed ahead of full reform. It is proposed that the following improvements are included in the interim package:

- improve the de minimis exemption; and
- extend the transitional rules for superior and non local holding companies.

2.30 These areas will also be revisited as part of full reform to determine if further improvements can be made.

2.31 During consultation it was made clear that it can be difficult or burdensome in compliance terms to establish an exemption for US Limited Liability Company (LLC) (and similar entities) and joint ventures companies under existing rules. Whilst the new exemptions may provide assistance to joint ventures companies in appropriate cases, the Government will continue to explore whether these exemptions could assist trading US LLCs (and similar entities) in this regard. In addition, HMRC will consider how its published guidance could provide further certainty on the availability of the motive test exemption on these issues.

Improve the de minimis exemption

2.32 A CFC can qualify for exemption if its chargeable profits do not exceed £50,000 in a 12 month accounting period. There is a case for increasing the de minimis exemption limit for groups which include companies larger than those falling within the EU definition of small and medium sized enterprises. The Government therefore proposes to increase the limit for such groups from £50,000 to £200,000 (see A.27 to A.31 of Annex A).

2.33 The Government also proposed to change the measure of profits from one which requires the application of full UK tax law to the CFCs accounts ('chargeable profits') to one based on accounting profits. This should make it easier to identify whether the exemption applies and should reduce compliance burdens. Moving away from 'chargeable profits' makes it unnecessary to apply the existing detailed CFC rules, and removes the requirement for full UK tax rules to be applied. While greatly simplifying the process, this change is not without some avoidance risk, and so the measure includes limited anti-avoidance rules.

2.34 For SMEs, the de minimis limit will remain at £50,000. But the move from chargeable profits to an accounts based measure should make the exemption more useful to these groups.

Extend the transitional rules for superior and non local holding companies

2.35 Finance Act 2009 included transitional rules for superior and non local holding companies to ensure they could continue to qualify for exemption under the exempt activities test for the period to July 2011. The Government will extend these transitional rules for an additional 12 months to ensure that the exemption provided remains available until the completion of CFC reform in 2012 (see A.32 of Annex A).

Next steps for the consultation process

Responses and enquiries should be sent Robert Edwards or Jennifer Payne at:

CFC reform
Corporate tax team
HM Treasury
1 Horse Guards Road
London, SW1A 2HQ.

Or alternatively:

Robert Edwards on Robert.edwards@hmtreasury.gsi.gov.uk or 020 7270 5276

Jennifer Payne on Jennifer.payne@hmtreasury.gsi.gov.uk or 020 7270 5072

HM Treasury Corporate Tax Reform team on corporatetaxreform@hmtreasury.gsi.gov.uk

Confidentiality

2.36 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOI), the Data Protection Act 1998 (DPA) and the Environmental Information regulations 2004.

2.37 If you want the information that you provide to be treated as confidential, please be aware that, under the FOI, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Treasury (HMT) and HMRC.

2.38 HMT and HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

A Technical note on CFC interim improvements

Intra Group Activities Exemption

A.1 The legislation will include requirements in respect of the following :

- business establishment
- business activities
- amount of finance income and income arising from IP
- extent of connection with the UK

A.2 The business establishment condition will mirror that already included in the current exempt activities test. As with that test, the intention is to require sufficient substance in the territory of residence.

A.3 The business activities condition will require the majority of the CFC's business to be trading activity. As with the current exempt activities test, the approach will be to set out those activities which do not qualify as trading activities. The non-trading activities definitions will be similar to the definitions of "investment business" in the existing legislation. In order to meet this condition, no more than 10% of the business can consist of non-trading activities.

A.4 There will be a specific restriction in respect of insurance business carried out by non-insurance groups, often referred to as captive insurance arrangements.

A.5 Finance income and income from intellectual property condition: there will be a separate limitation in respect of this income. This will be set at 5% of total gross income. Finance and IP income in excess of this amount will be subject to a CFC charge.

A.6 UK business connection condition: as this new intra-group exemption is designed primarily for 'foreign to foreign' trading transactions, the legislation will limit the extent to which the CFC can have transactions or business connections with the UK.

A.7 The proposed approach is to test the gross income and the business expenditure of the CFC to measure to what extent that income arises from, or expenditure is incurred with, the UK. This UK connection condition will not distinguish between connected and unconnected parties.

A.8 The condition will be met if no more than 10% of the gross income or expenditure of the CFC arises from a UK connection.

A.9 Even if there is a connection with the UK of more than 10%, but not more than 50%, full exemption will be available to CFCs whose overall level of profitability is sufficiently low to indicate a limited Exchequer risk, and which is effectively managed in the territory. For this purpose, effective management means sufficient individuals working in the territory of residence, or in any other territory outside the UK, who have the competence and authority to undertake all, or substantially all, of the company's business. The profitability measure will be a mechanical test. If these conditions are not satisfied, then the UK company with a relevant interest in the CFC may apply to HMRC for a reduction in the CFC charge. Further detail is provided at paragraph A.33

A.10 If the level of UK connection exceeds 50%, this exemption will not be available.

Non-UK Intellectual Property Exemption

A.11 This exemption is designed to exclude from charge profits from intellectual property with little or no connection to the UK. The legislation will impose requirements in respect of the following :

- business establishment
- business activities
- UK connection
- finance income

A.12 The business establishment test will mirror that set out in the current legislation.

A.13 The business activities condition will require that the main business of the CFC is the exploitation of IP, and that any secondary activities would, if treated as the main business, satisfy either the existing exempt activities test, or the new intra-group exempt activities test.

A.14 In addition, the business activities condition will determine whether the IP has a UK connection. In this context, the UK connection will be measured by reference to the following factors :

- whether the IP has been held in the UK within the preceding 10 years
- whether activities in relation to the creation, development, maintenance or enhancement of the IP have been carried on in the UK

A.15 Failure of either condition will mean that the exemption is not available. These restrictions are intended to prevent IP diverted from the UK from benefiting from this exemption.

A.16 The UK connection condition: this condition will determine whether the level of UK connection is such that the IP cannot be considered to be remote from the UK. This will be measured by reference to the following factors :

- The extent to which funding to acquire, maintain or enhance the IP has been provided from the UK, other than by debt funding.
- The extent to which the income of the CFC is derived from sales in the UK
- The extent to which R&D expenditure is incurred in the UK – incidental or insignificant expenditure will be disregarded.

A.17 This condition will not be met unless the extent of UK connection is minimal.

A.18 Finance income is limited to 5% of gross income, with the excess subject to a CFC charge. The machinery by which the CFC charge is fixed by reference to the excess finance income is detailed at paragraph A33.

Suspension of CFC rules following acquisition or reorganisation

A.19 New rules will be introduced to formalise and expand the current 'period of grace' approach in respect of acquisitions and reorganisations.

A.20 The CFC rules will not apply to relevant companies for a period starting on the date of acquisition or reorganisation and ending 24 months after the end of the accounting period in which the acquisition takes place. In practice, this will be a period of up to 3 years.

A.21 The exemption will apply in relation to the following types of CFC :

- Companies not previously under UK control
- Acquisition vehicles set up in order to acquire such companies from third parties

A.22 The exemption will cover both acquisitions from third parties, and certain types of group reorganisations – for example, where a non-UK headed group sets up a regional holding company in the UK, and in doing so brings the group’s subsidiaries held by that company within the scope of the UK CFC rules. Similarly, the exemption will apply to groups migrating into the UK.

A.23 For third party transfers of companies between UK groups during a period of temporary exemption, it is intended that the balance of the period will be available to the acquiring group.

A.24 The period of suspension will cease for a CFC if, during the period, there is a relevant change in the business of that CFC. Whether a change is relevant will be measured by reference to whether there is a reduction in UK tax as a result of that change.

A.25 For the accounting period in which a relevant change occurs, a partial CFC charge may arise in order to deal with the reduction in UK tax identified. The partial charge mechanism is covered below at paragraph A33.

A.26 For accounting periods outside this exemption period, the other CFC exemptions will apply in the usual way.

De Minimis Exemption

A.27 The computation of profits for the de minimis exemption will be simplified by replacing the current UK chargeable profits approach with an accounts based measure of profits.

A.28 In addition, for UK-headed groups with at least one large company as a member, the current £50,000 limit for a CFC in such a group will be replaced by a £200,000 limit. The smaller limit will remain for groups consisting only of small and medium sized companies. As currently, these limits will be proportionally reduced for accounting periods of less than 12 months. Small and medium sized companies are defined by reference to the EU definition.

A.29 The starting point for the profits calculation will be the total profits (excluding capital gains or losses) calculated in accordance with GAAP.

A.30 Those accounting profits will then need to be adjusted in line with the transfer pricing rules. However, if the difference between the accounts profits and the transfer pricing adjusted profits is less than £50,000, the transfer pricing adjustment can be disregarded. This approach is intended to provide some protection against manipulation of profits without imposing an undue compliance burden.

A.31 There will be anti-avoidance measures to ensure that groups do not arrange their affairs purely to take advantage of this exemption. Potential CFCs involved in such arrangements will be prevented from claiming the de minimis exemption.

Holding Company Exemption

A.32 The transitional holding company rules scheduled to expire in July 2011 will be extended until July 2012. This is intended to cover the period until full CFC reform takes place.

Partial exemption mechanism

A.33 A mechanism will be introduced to enable a partial CFC exemption for entities which do not meet the conditions for full exemption.

A.34 The mechanism will be similar in approach to that used by s751A in that the UK resident company with a relevant interest in the CFC will make an application to HMRC, but rather than specify the amount that an apportionment can be reduced by, the new rules will enable groups to specify the amount of the CFC apportionment. In other words, the new rules will enable a group to assess the proportion of its profits which should be subject to a CFC charge.

A.35 Applications may be required in any of the following circumstances:

- IP and non-IP CFCs where financial income exceeds 5% of gross income.
- Non-IP CFCs where the combined financial and IP income exceeds 5% (in these circumstances the IP income will be deemed to be interest income)
- Non-IP CFCs where the level of UK connection exceeds 10% but not 50%.
- CFCs whose period of temporary exemption has ended due to a relevant business change

A.36 With regard to the first two bullet points above, the legislation will specify that the assessable profits cannot be less than the excess income. For example, assuming a 5% limit:

- finance income is 7% of gross income: 2% of financial income will be subject to a CFC charge.
- finance income is 6% of gross income ; income from IP is 4% of gross income. Of this 10% total, 5% will be subject to a CFC charge.

A.37 For simpler issues such as excess finance income, it is intended that the mechanism will be sufficiently certain to allow groups to determine their CFC liability.

A.38 With regard to non IP CFCs where the level of UK connection exceeds 10% but not 50%, the legislation will require an assessment of the economic value added by the CFC and the extent to which the profits of the CFC have arisen as a result of transactions with the UK. There will be an element of subjectivity in any such assessment – and for that reason the application mechanism will enable such cases to be discussed with HMRC.

A.39 With regard to a period of temporary exemption that has ended due to a relevant business change, the legislation will require an assessment of the extent to which profits are attributable to the relevant business change – again, there will be an element of subjectivity in any such assessment, and such cases can be discussed with HMRC.

B

Summary of questions

This Annex summarises the questions raised throughout this Part of the Document

New exemption for certain intra group activities

- **Question 2A:** Are the proposed parameters of the relevant conditions of the new exemption an appropriate response at the interim stage whilst still providing adequate protection of the UK tax base?
- **Question 2B:** Is the proposed percentage limit for finance income sufficient and is there a case for providing greater flexibility for finance income that is a necessary incident or which is integral to the CFC's trade?
- **Question 2C:** When considering UK connection, is there a case for distinguishing between transactions with connected parties and those with third parties? Are there circumstances in which third party transactions could be left out of account?
- **Question 2D:** With regard to the 'safe harbour', are there alternative parameters which would be more effective? What might be the most suitable measure of such parameters?
- **Question 2E:** The proposed approach to partial exemption is to ensure that the rules are more targeted, moving away from the all or nothing approach of the current rules. Is the approach suggested workable?

Exploitation of IP with no UK connection

- **Question 2F:** Recognising that this IP exemption is intended to be narrow in scope, are there any changes to the design parameters that would make it more useful to business in advance of full reform but which would not increase the risk of UK tax base erosion?
- **Question 2G:** Is the restriction in reference to research and development expenditure in the UK appropriate and is the proposed approach practical? If not, is there another more suitable parameter that could be used?

Temporary exemption following acquisition or reorganisation

- **Question 2H:** The proposal will include the ability for businesses to apply to HMRC for an extension to the period of temporary exemption, in exceptional circumstances. What genuine reasons would there be for needing such an extension?