

**FINANCE BILL 2012
CLAUSE 180
SCHEDULE 20**

EXPLANATORY NOTE

**CLAUSE 180 SCHEDULE 20: CONTROLLED FOREIGN COMPANIES AND
FOREIGN PERMANENT ESTABLISHMENTS**

AMENDMENTS [1] to [3]

SUMMARY

This clause and schedule provide for a new regime for controlled foreign companies (CFC) to be inserted as Part 9A of the Taxation (International and Other Provisions) Act 2010 (TIOPA), and repeal the current CFC rules in Chapter 4 of Part 17 of the Income and Corporation Taxes Act 1988 (ICTA). The clause and schedule also provide for the new regime to apply, with necessary adaptations, to the rules for foreign permanent establishments in Chapter 3A of Part 2 of the Corporation Tax Act 2009 (CTA 2009).

Statutory references in this explanatory note are to TIOPA unless specified otherwise.

Amendments [1] and [3]

Paragraph 42 of the Schedule introduces new section 314A, which treats a CFC charge that is made in respect of certain finance profits as a financing income amount for the purposes of Part 7 TIOPA (the debt cap). In this way, the CFC's profits are treated for the purposes of the debt cap as if they had been a financing income amount of the UK resident company that incurs the CFC charge. The purpose of section 314A is to ensure the correct interaction between the new CFC regime and the debt cap so as to prevent double charges from arising.

New section 371IE is the 'matched interest rule'. This rule gives exemption from the CFC charge in respect of qualifying loan relationship profits in cases where UK group companies have more financing income than financing expense. These terms take the same meaning as they have for the debt cap and so include financing income amounts that are included by virtue of section 314A.

For both of these purposes, amendments [1] and [3] correct a mistake whereby the same financing income amount could have been taken into account in two periods of account of the worldwide group. This would happen if the CFC charge arose in a corporation tax accounting period of a group company that straddled two periods of account of the worldwide group. To prevent this happening the amendments ensure that the financing income amount is taken into account only in the period of the worldwide group in which the CFC's accounting period ends.

Amendment [2]

The debt cap takes effect through a combination of disallowance of deductions and exemption of income. In circumstances where the debt cap applies it is the balance of the two types of adjustment that gives rise to an appropriate aggregate net increase in corporation tax profits across the UK group.

The rule in the debt cap that provides exemption for certain financing income amounts is in section 293. Its effect extends to all corporation tax purposes, but

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because the CFC charge is not a charge to corporation tax, it will not allow for a reduction in the CFC charge. This means that, despite the treatment of the CFC profits as a financing income amount by virtue of section 314A, there are circumstances in which a double charge may arise.

New Paragraph 40B introduces new section 298A which allows HMRC Commissioners to make regulations to reduce a CFC charge that is a financing income amount to the same extent as the corporation tax charge is reduced for other financing income amounts. In this way the regulations will eliminate a double charge while retaining the restrictive effect of the debt cap on interest deductions. The regulations may also make consequential changes to both the debt cap and the CFC regime, as appropriate.

BACKGROUND NOTE

Schedule 20 provides for a new CFC regime that supports the Government's objective to deliver a more competitive corporate tax system. The policy objectives of the new CFC regime are to:

- introduce a modernised CFC regime that better reflects the way that businesses operate in a global economy whilst maintaining adequate protection of the UK tax base;
- exempt profits where there is no artificial diversion of UK profits; and
- exempt profits arising from genuine economic activities undertaken overseas.

The Government announced this measure at the Budget in June 2010 and outlined the policy proposals on 29 November 2010 as part of the Corporate Tax Reform document.

Detailed proposals for this measure were published for consultation in *Controlled Foreign Companies (CFC) reform* in June 2011. On 6 December 2011 the Government published *Controlled Foreign Companies (CFC) reform: response to consultation* which provides an update on the developments on the reform of Controlled Foreign Companies rules following consultation and includes a summary of the responses received and a technical note which gives an overview of the legislation. Further updates were published on 31 January 2012 and 29 February 2012. All documents are available on the HM Treasury website.

The measure also amends the exemption for profits arising in foreign permanent establishments, so that the rules are brought into line with the new CFC regime.

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PUBLIC BILL COMMITTEE

FINANCE BILL

David Gauke

1

Schedule 20, page 457, line 10, leave out ‘and’ and insert—
‘(ba) the CFC’s accounting period ends in that period of account,
and’.

David Gauke

2

Schedule 20, page 520, line 1, at beginning insert—
‘40B In Chapter 4 of Part 7 (exemption for financing income) after section 298
insert—

**“298A Application of Chapter to financing income amounts determined
under section 314A**

- (1) The Commissioners may by regulations amend this Chapter—
 - (a) to enable a financing income amount determined in accordance with section 314A for the relevant period of account (or a proportion of such an amount so determined) to be specified in a statement of allocated exemptions under section 292(4)(b), and
 - (b) to require, where a financing income amount so determined (or a proportion of such an amount so determined) is specified in such a statement, the sum charged on the company as mentioned in section 314A(1)(a) to be re-determined at step 5 in section 371BC(1) on the basis set out in subsection (2) below.
- (2) The basis referred to in subsection (1)(b) is—
 - (a) the relevant finance profits (see section 314A(1)(c)) are to be left out of the CFC’s chargeable profits mentioned in paragraph (a) at step 5 in section 371BC(1), and
 - (b) the CFC’s creditable tax mentioned in paragraph (b) at that step is to be reduced so far as it is just and reasonable for it to be reduced having regard to the amounts left out of the CFC’s chargeable profits.
- (3) For a case where only a proportion (“X%”) of a financing income amount is specified in a statement of allocated exemptions under section 292(4)(b), in subsection (2)(a) the reference to the relevant finance profits is to be read as a reference to X% of those profits.

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- (4) The Commissioners may by regulations amend this Chapter to require, where a financing income amount determined in accordance with section 314A for the relevant period of account is reduced under section 296, the sum charged on the company as mentioned in section 314A(1)(a) to be re-determined in accordance with provision made by regulations under subsection (1)(b) as if the proportion of the financing income amount represented by the amount of the reduction were specified in a statement of allocated exemptions under section 292(4)(b).
- (5) The Commissioners may by regulations amend this Part or Part 9A in consequence of provision made by regulations under subsection (1) or (4).””.

David Gauke

3

Schedule 20, page 520, line 12, leave out ‘and’ and insert—
‘(ba) the CFC’s accounting period in relation to which the sum is charged ends in the period of account of the worldwide group, and’.