



Changes to the debt cap provisions

Who is likely to be affected?

Certain companies which are members of large groups.

General description of the measure

The measure comprises two changes to improve the effectiveness of the world wide debt cap (WWDC). The first change is to the grouping rules and the second change is to the regulation-making powers.

Policy objective

The WWDC broadly limits the corporation tax deduction for interest and other finance expenses of the UK members of large groups of companies to the amount of the finance expenses of the world wide group.

The first change made by this measure protects revenue and puts beyond doubt the way in which the grouping rules apply. The change to the regulation-making powers enables changes to be made to reduce the possible impact of the WWDC on whole business securitisations.

Background to the measure

The debt cap rules were introduced in Finance Act 2009. The change to the grouping rules and the change to the regulation-making powers were announced on 5 December 2013. Draft regulations under the existing power were published for comment in November 2012, but not taken forward as they were considered to be burdensome and unnecessary at that time. The change to the regulation-making powers will enable future regulations (if required) to be more efficient and simpler for both business and HM Revenue & Customs (HMRC) to operate.

Detailed proposal

Operative date

This measure will have effect in respect of the change to the grouping rules for accounting periods starting on or after 5 December 2013. The change to the regulation-making powers will have effect on or after the date that Finance Bill 2014 receives Royal Assent.

Current law

Part 7 of The Taxation (International and other Provisions) Act 2010 (TIOPA) contains the WWDC rules. These rules apply to large groups of companies. Section 345 TIOPA provides the meanings of the terms 'UK group company', 'relevant group company' and 'relevant subsidiary' for the purposes of applying the WWDC rules. These, in turn, refer to certain definitions in Part 5 of the Corporation Act 2010, which provides the Group Relief rules for companies.

Section 353A of TIOPA contains the regulation-making power for regulations enabling elections to transfer WWDC liabilities within a group with a securitisation structure.

Proposed revisions

Legislation will be introduced in Finance Bill 2014. This changes the grouping rules to ensure that a UK tax-resident company that does not have ordinary share capital such as a company limited by guarantee, can be a relevant group company subject to the WWDC. It also modifies the definition of a 75 per cent subsidiary for the WWDC rules to ensure that indirect ownership of a company can be traced through intermediate entities without ordinary share capital. Furthermore, it puts it beyond doubt that the ultimate parent of a worldwide group may be regarded as beneficially entitled to 75 per cent of the profits or assets of a UK group company for the purposes of the WWDC grouping rules, notwithstanding any intermediate entities in the ownership chain that do not have ordinary share capital.

The amendment to the regulation-making powers enables regulations to include conditions to be met by companies making an election to transfer WWDC liabilities to another group company.

Summary of impacts

Exchequer impact (£m)	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
	nil	nil	nil	nil	nil	nil
	This measure is not expected to have an Exchequer impact. This measure supports the Exchequer in its commitment to protect revenue.					
Economic impact	The measure is not expected to have any significant economic impacts.					
Impact on individuals and households	The measure will not have any impact on individuals and households as it relates to groups of companies that are subject to the debt cap.					
Equalities impacts	The measure is not expected to have any equalities impact.					
Impact on business including civil society organisations	<p>This measure is expected to have a negligible impact on businesses and civil society organisations.</p> <p>The debt cap rules only apply to around 1,800 corporate groups which include large companies, and small and medium enterprises and civil society organisations are not expected to be affected by this change.</p> <p>The change to the grouping rules clarifies the current law and is therefore not expected to have any impact on administration burdens.</p> <p>The change to the regulation-making powers will affect a small number of groups with a negligible impact.</p>					
Operational impact (£m) (HMRC or other)	It is not expected that implementing these changes will incur any significant additional costs for HMRC.					
Other impacts	Other impacts have been considered and none have been identified.					

Monitoring and evaluation

The measure will be monitored through information collected from tax returns and through communication with taxpayer groups affected by the measure.

Further advice

If you have any questions about this change, please contact Judith Diamond on 03000 585712 (email: judith.diamond@hmrc.gsi.gov.uk) or Roger Muray on 03000 585376 (email: roger.muray@hmrc.gsi.gov.uk).

Declaration

David Gauke MP, Exchequer Secretary to the Treasury has read this Tax Information and Impact Note and is satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impacts of the measure.

1 Tax treatment of financing costs and income

- (1) Chapter 10 of Part 7 of TIOPA 2010 (tax treatment of financing costs and income: interpretation) is amended as follows.
- (2) In section 345 (meaning of “UK group company” and “relevant group company”), for subsection (7) substitute—
 - “(7) Chapter 6 of Part 5 of CTA 2010 (equity holders and profits or assets available for distribution) and Chapter 3 of Part 24 of that Act (subsidiaries) apply for the purposes of subsection (6), subject to subsections (8) and (9).
 - (8) Sections 169 to 182 of CTA 2010 do not apply.
 - (9) In applying the remaining provisions of those Chapters for the purposes of subsection (6), they are to be read with all modifications necessary to ensure that—
 - (a) they apply to a company or other body corporate which does not have share capital, and to holders of corresponding ordinary holdings in such a company or body, in a way which corresponds to the way they apply to companies with ordinary share capital and holders of ordinary shares in such companies,
 - (b) they apply in relation to ownership through an entity (other than a body corporate), or any trust or other arrangement, in a way which corresponds to the way they apply to ownership through a company or other body corporate, and
 - (c) for the purposes of achieving paragraphs (a) and (b), profits or assets are attributed to holders of corresponding ordinary holdings in entities, trusts or other arrangements in a manner which corresponds to the way profits or assets are attributed to holders of ordinary shares in a company.
- (10) In this section “corresponding ordinary holding” in an entity, trust or other arrangement means a holding or interest which provides the holder with economic rights corresponding to those provided by a holding of ordinary shares in a company.”
- (3) In section 353A (effect of Part 7 on parties to capital market arrangements), in subsection (4), before paragraph (a) insert—
 - “(za) the conditions that must be met in relation to company A for an election to be made;”.
- (4) The amendment made by subsection (2) has effect in relation to periods of account of the worldwide group starting on or after 5 December 2013.

EXPLANATORY NOTE

TAX TREATMENT OF FINANCING COSTS AND INCOME

SUMMARY

1. Clause [X] makes amendments to the “worldwide debt cap” (WWDC) legislation which places certain limitations on the deductibility of interest and similar expenses in computing corporation tax where the combined funding expenses of the UK members of a group exceed the funding expenses of the group as a whole. The changes clarify the position in cases where a group includes entities that do not have ordinary share capital. The measure also makes a minor change to the power to make regulations relevant to the potential impact of the provisions on whole business securitisations.

DETAILS OF THE CLAUSE

2. Subsection (1) provides that Chapter 10 of Part 7 of the Taxation (International and Other Provisions) Act 2010 (TIOPA) is amended.

3. Subsection (2) amends subsection 345(7) TIOPA and inserts new subsections 345(8) to 345(10).

4. Amended subsection 345(7) TIOPA allows the meaning of 75per cent subsidiary in subsection 345(6)(a) for the purposes of the WWDC to be determined by reference to the definitions in Chapter 3 of Part 24 of the Corporation Tax Act 2010 (CTA 2010). It also allows for the provisions of Chapter 6 of Part 5 of CTA 2010 to be applied in determining the extent to which the ultimate parent is beneficially entitled to the profits or assets of a UK group company for the purposes of subsections 345(6)(b) or (c). In each case this is subject to the modifications set out in new subsections 345(8) and 345(9). These modifications are designed to have the following overall effects.

5. The definition of a 75 per cent subsidiary is widened, in its application to the WWDC legislation, such that a company without share capital can be a 75per cent subsidiary of the ultimate parent. Also, in dealing with indirect subsidiaries, ownership can be traced through entities that do not have share capital.

6. A UK group company can be a relevant group company, even if it is not a 75per cent subsidiary, where the ultimate parent is beneficially entitled to 75per cent of the profits available for distribution by the company or 75per cent of the net assets available for distribution in a winding up.

7. These changes put it beyond doubt that the ultimate parent’s beneficial entitlement to profits or assets can be traced through any intermediate company, entity, trust or arrangement.

8. In particular, new subsection 345(8) TIOPA provides that sections 169 to 182 of CTA 2010 do not apply for the purposes of the WWDC legislation. These provisions, which are primarily designed to ensure that 75 per cent subsidiaries with shares carrying variable or complex rights are not artificially included in a group relief group, are not required in the context of the WWDC.

9. One consequence of new subsection 345(9)(a) is that it ensures that a UK group company that does not have ordinary share capital, such as a company limited by guarantee, is capable of being a relevant group company. It introduces the term “corresponding ordinary holding”, defined in new subsection 345(10).

10. New subsection 345(9)(b) makes it clear that, in applying the rules in Chapter 6 of Part 5 or Chapter 3 of Part 24 of CTA 2010, ownership or beneficial entitlement to distributable profits can be traced through entities that do not have ordinary share capital in the same way as they might be traced through companies with ordinary share capital.

11. New subsection 345(9)(b) provides that, when ownership or beneficial entitlement is traced in this way, the holders of a “corresponding ordinary holding” (see below) are treated in the same way as holders of ordinary shares. Accordingly, the corporation tax rules which determine the profits and assets of a company available for distribution, and the rules on indirect ownership of shares apply to “corresponding ordinary holdings” in the same manner as they do to holdings of ordinary shares.

12. New subsection 345(10) defines a “corresponding ordinary holding”. The key feature of such a holding is that it conveys economic rights corresponding to those conveyed by a holding of ordinary shares, without regard to the legal form of the holding or any instruments that might comprise that holding. For example, a foreign partnership may have different classes of interests: preferred interests that convey rights to only a fixed amount of profit or percentage return on capital and residual interests that convey the rights to a share of the residual profit or surpluses on asset disposals. A holding of residual interests would be considered to be a corresponding ordinary holding, whereas a holding of preferred interests would not.

13. Subsection (3) amends section 353A(4) TIOPA to the effect that regulations made under the section may require company A, a party to a capital market arrangement, to meet certain conditions (such as being required to provide security over its assets) before it is permitted to make an election under regulations made under section 353A.

BACKGROUND NOTE

14. Finance Act 2009 introduced a package of changes to the taxation of companies on their foreign profits. One of these measures limits the interest and other finance expenses that can be deducted in computing the corporation tax payable by UK members of a worldwide group of companies, and is commonly referred to as the worldwide debt cap (WWDC).

15. The rules broadly operate by requiring UK groups to compare their UK financing costs, as calculated under the rules, with the finance costs of their worldwide group. If the UK costs exceed the worldwide costs then the excess is disallowed and the UK companies do not get any relief for the excess.

16. The WWDC applies to companies that are “relevant group companies” in a “worldwide group”. The worldwide group is defined by reference to a group for the purposes of international financial reporting standards. A relevant group company is, broadly, a subsidiary within that group within the charge to UK corporation tax, which is a 75per cent subsidiary of the ultimate parent. This includes the case where the parent has a beneficial entitlement to 75per cent of the profits of that company, or 75per cent of the assets of that company that are available in a winding up.

17. The amendments clarify how the group relief rules are to apply, for the purposes of the WWDC, in the context of a multinational group that may have a complex structure and include a wide range of entities, including companies that do not have ordinary share capital and entities that are not bodies corporate. Such entities may, for example, include a company limited by guarantee. They also ensure that indirect ownership of a company can be traced through intermediate entities without ordinary share capital, and put it beyond doubt that the ultimate parent of a worldwide group may be beneficially entitled to 75per cent of the profits or assets of a UK group company notwithstanding any intermediate entities in the ownership chain that do not have ordinary share capital.

18. At the same time a minor change is made to the regulation making powers relating to the WWDC, to facilitate the making of regulations to enable companies involved in whole business securitisations to remain bankruptcy remote.

19. If you have any questions about this change, or comments on the legislation, please contact Roger Muray on 03000 585376 (email: roger.muray@hmrc.gsi.gov.uk) or Judith Diamond on. 03000 585712 (email: judith.diamond@hmrc.gsi.gov.uk).