



Controlled foreign companies: profit shifting

Who is likely to be affected?

Companies that are intending to transfer to controlled foreign companies (CFCs) profits from UK intra-group loans may be affected by this measure.

General description of the measure

The measure switches off the partial exemption rules for loan relationship credits of a CFC that arise from an arrangement with a main purpose of transferring profits from existing intra-group lending out of the UK.

The measure also amends the anti-avoidance rule relating to the transfer of external debt to the UK to ensure that the rule works as intended.

Policy objective

The measure reinforces the policy aim of the CFC rules which is to protect the UK from artificial diversion of profits whilst contributing to a more competitive CT regime.

Background to the measure

This measure was announced on 5 December 2013.

Detailed proposal

Operative date

The first part of the measure will apply to arrangements entered into on or after 5 December 2013.

The second part will have effect for accounting periods beginning on or after 5 December 2013.

Current law

Part 9A of Taxation (International and Other Provisions Act) 2010 (TIOPA 2010) provides the CFC rules in respect of accounting periods of the CFC beginning on or after 1 January 2013 (subject to certain transitional provisions). Chapter 2 sets out the overall framework for charging tax on certain profits of CFCs. Chapters 3-8, referred to as 'the CFC charge gateway', define which profits of a CFC are chargeable, subject to exemptions in Chapters 9-14.

Chapter 5 is the CFC charge gateway for non-trading finance profits (NTFPs), which include interest and interest-like receipts from intra-group financing arrangements. It is subject, on making a claim, to Chapter 9, which provides for a full or 75 per cent exemption for qualifying loan relationships (QLRs). Profits from other loan relationships continue to be dealt with under Chapter 5.

Section 371IG defines QLRs as, broadly speaking, loans to fund other group companies that do not fall within any of the exclusions in section 371IH.

Sub-section 371IH(10) is an anti-avoidance provision that prevents certain loans from being QLRs where UK connected parties have borrowed funds from third parties or non-UK residents and used those funds to finance a CFC to make a loan which itself is used to repay third party debt of the ultimate debtor of the loan.

Proposed revisions

Legislation will be introduced in Finance Bill 2014 to establish a new rule into Chapter 9 which prevents a creditor relationship of a CFC from being a QLR if it arises as a result of any arrangement which has a main purpose of transferring out of the UK profits from a loan made by a UK company connected with the CFC..

The effect of this rule will be to stop the full or partial exemption provisions at section 371IB or section 371ID applying to the creditor relationship of the CFC in question.

The rule will apply on a loan by loan basis.

The rule will ensure that further arrangements cannot be entered into to circumvent its effect.

In addition the legislation in Chapter 9 sub-section 371IH (10) will be amended to ensure the rules on the definition of QLRs work as intended.

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.					
Economic impact	This measure is not expected to have any significant economic impacts.					
Impact on individuals and households	The measure has no impact upon individuals and households as it is a corporate measure					
Equalities impacts	The measure only affects corporate entities, not individuals, and no impacts have been identified.					
Impact on business including civil society organisations	The measure is expected to have a negligible impact on compliant businesses and civil society organisations.					
Operational impact (£m) (HMRC or other)	Extra operational costs incurred as a result of this measure are likely to be negligible.					
Other impacts	Other impacts have been considered and none have been identified.					

Monitoring and evaluation

This measure will be monitored through collecting information from tax returns and monitoring clearances.

Further advice

If you have any questions about this change, please contact Paula Jarnecki on 03000 585583 (email: paula.jarnecki@hmrc.gsi.gov.uk) or contact Paul Croasdale on 03000 585572 (email: paul.croasdale@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 Controlled foreign companies: qualifying loan relationships (1)

- (1) In Chapter 9 of Part 9A of TIOPA 2010 (controlled foreign companies: qualifying loan relationships) in section 371IH (exclusions from definition of “qualifying loan relationship”) after subsection (9) insert –

“(9A) Subsection (9B) applies to a creditor relationship of a CFC if –

- (a) a UK connected company has a creditor relationship (“the UK creditor relationship”) in relation to which a non-UK resident company connected with the UK connected company is the debtor,
- (b) directly or indirectly in connection with the UK creditor relationship, an arrangement (“the relevant arrangement”) is made, and
- (c) the main purpose, or one of the main purposes, of the relevant arrangement is to secure that –
 - (i) the relevant UK credits of a UK connected company for a corporation tax accounting period of the company are lower than they would be if the relevant arrangement had not been made, or
 - (ii) the relevant UK debits of a UK connected company for a corporation tax accounting period of the company are greater than they would be if the relevant arrangement had not been made.

(9B) The CFC’s creditor relationship cannot be a qualifying loan relationship if it is, or is connected (directly or indirectly) to, the relevant arrangement.

(9C) In subsection (9A) –

“corporation tax accounting period” means an accounting period for corporation tax purposes,

“relevant UK credits”, in relation to a UK connected company, means credits which the company has under Part 5 or 7 of CTA 2009,

“relevant UK debits”, in relation to a UK connected company, means debits which the company has under Part 5 or 7 of CTA 2009, and

“UK connected company” means a UK resident company which –

- (a) is connected with the CFC, or
- (b) was connected with a company with which the CFC is connected.”

- (2) The amendment made by this section has effect for cases in which the relevant arrangement is made on or after 5 December 2013.

2 Controlled foreign companies: qualifying loan relationships (2)

- (1) In Chapter 9 of Part 9A of TIOPA 2010 (controlled foreign companies: qualifying loan relationships) in section 371IH (exclusions from definition of “qualifying loan relationship”) in subsection (10)(c) for “wholly or mainly used” substitute “used to any extent (other than a negligible one)”.
- (2) The amendment made by this section has effect for accounting periods of CFCs beginning on or after 5 December 2013.
- (3) The following subsections apply in relation to a qualifying loan relationship of a CFC if –
 - (a) profits of the qualifying loan relationship (“the relevant profits”) would, apart from those subsections, be included in the CFC’s qualifying loan relationship profits for an accounting period of the CFC (“the straddling period”) which begins before 5 December 2013 but ends on or after that date, and
 - (b) the creditor relationship in question would not be a qualifying loan relationship for the straddling period were the amendment made by this section to have effect for accounting periods of CFCs beginning before 5 December 2013.
- (4) Apportion the relevant profits between the part of the straddling period falling before 5 December 2013 and the part falling on or after that date –
 - (a) in accordance with section 1172 of CTA 2010 (time basis), or
 - (b) if that method produces a result that is unjust or unreasonable, on a just and reasonable basis.
- (5) The relevant profits are to be excluded from the CFC’s qualifying loan relationship profits for the straddling period so far as they are apportioned to the part of the straddling period falling on or after 5 December 2013.

EXPLANATORY NOTE

CONTROLLED FOREIGN COMPANIES: QUALIFYING LOAN RELATIONSHIPS

SUMMARY

1. Clause [X] introduces two amendments to the Controlled Foreign Companies (CFC) regime at Part 9A of the Taxation (International and Other Provisions) Act 2010 (TIOPA). Both amendments are to Chapter 9 of Part 9A.
2. The first amendment prevents a CFC's non-trading finance profits benefiting from the partial or full exemption under Chapter 9 if they are connected with an arrangement that has a main purpose of artificially diverting into a CFC non-trading finance profits that are currently received by a UK resident company.
3. The second amendment closes a loophole in an existing rule under Chapter 9 that prevents a creditor relationship of a CFC benefitting from partial or full exemption when third party debt of a non-UK resident group company is repaid and effectively replaced with new UK debt.
4. The amendments will have effect from 5 December 2013.

DETAILS OF THE CLAUSE

5. Clause [X] contains amendments to Part 9A TIOPA.

Part 1

6. Subsection 1 inserts new section 371IH(9A), (9B) and (9C) into section 371IH of Chapter 9.
7. New section 371IH(9A) applies new section 371IH(9B) to a creditor relationship of a CFC if three conditions are met. These are that there must be a loan, made by a connected UK resident company to a connected non-UK resident company; an arrangement is made directly or indirectly in connection with this loan (the relevant arrangement); and the main purpose, or one of the main purposes, of the relevant arrangement is to achieve a reduction in relevant UK credits or increase in relevant UK debits of a UK connected company in comparison to what credits or debits would have been if the relevant arrangement had not been made.
8. New section 371IH(9B) prevents the creditor relationship of a CFC being a qualifying loan relationship under Chapter 9 if it is, or is connected (directly or indirectly) to, a relevant arrangement which falls within new sub-section (9A). The result of this is that the

profits from that creditor relationship of a CFC cannot benefit from the partial or full exemption in Chapter 9 of Part 9A TIOPA.

9. New section 371IH(9C) defines the terms used in new section 371IH(9A) as follows. A “corporation tax accounting period” is an accounting period for corporation tax purposes. “Relevant UK credits” and “relevant UK debits” are defined as the credits and debits which a UK connected company has under the rules in Parts 5 or 7 CTA 2009 (loan relationships and derivative contracts), which include credits and debits to which Part 5 applies by virtue of Part 6 CTA 2009. A “UK connected company” is a UK resident company which is either connected with the CFC, or was connected with a company with which the CFC is connected.

10. Example

A UK parent company has lent £100 million to a US subsidiary company. Interest of £5 million is received annually and subject to corporation tax as part of the profits of the UK parent company. The UK parent company enters into an arrangement in order to transfer the loan made to the US subsidiary to a new CFC in exchange for shares in the CFC. The relevant UK credits of the UK parent company are reduced as a result of the arrangement and it is established that a main purpose of the arrangement made was to achieve this reduction. The arrangement therefore falls within new section 371(IH)(9A). Accordingly, the creditor relationship of the CFC cannot be a qualifying loan relationship by virtue of new section 371(IH)(9B). The profits of £5 million arising in the CFC in respect of its creditor relationship with the US company fall within Chapter 5 CFC charge gateway for non-trading finance profits, but cannot benefit from the partial or full exemption under Chapter 9. The overall effect is that the interest that was previously subject to corporation tax becomes subject to a CFC charge so that there is no change in the amount of UK tax paid.

11. Subsection 2 provides for the commencement of the new rules, stating that new section 371IH(9A), (9B) and (9C) apply to relevant arrangements which are made on or after 5 December 2013.

Part 2

12. Subsection 1 amends section 371IH(10)(c) (exclusions from the definition of qualifying loan relationships), replacing the phrase “wholly or mainly used” with “used to any extent (other than a negligible one)”. This sub-section provides that a loan cannot be a qualifying loan relationship where it is used to repay third party debt of a non-UK resident group company and that debt is effectively replaced with new UK debt, as part of an arrangement where one of the main purposes is to obtain a tax advantage for any person. The rule is directed at arrangements that give rise to an increase in debt in the UK whether provided by a UK third party or by a non-UK resident person.

13. In modifying the wording to say “...the relevant loan is *used to any extent (other than a negligible one)* to repay wholly or partly another loan...” it will apply in circumstances where there is a larger intra-group loan, so that the element that is applied to

repay the external debt of the non-UK resident group company is a minority of the total amount of the loan.

14. Subsections 2 to 5 provide for commencement. Subsection 2 states that the amendments to section 371IH(10)(c) will have effect for accounting periods of CFCs beginning on or after 5 December 2013.

15. Subsection 3 stipulates that the modified section 371IH(10)(c) will also apply to accounting periods of the CFC which begin before 5 December 2013, but end on or after that date. Such an accounting period is termed “the straddling period”. Sections 3, 4 and 5 apply the amended section 371IH(10)(c) to such periods, so as to exclude the profits arising after 5 December 2013 from the qualifying loan relationship profits of the CFC.

16. Subsection 4(a) provides that any apportionment for qualifying loan relationship profits of accounting periods which straddle 5 December 2013 should be made in accordance with section 1172 of CTA 2010 (an apportionment on a time basis). Where a time basis apportionment produces a result that is unjust or unreasonable, subsection 4(b) provides for apportionment on a just and reasonable basis.

17. Subsection 5 specifies that the profits from the qualifying loan relationships apportioned to the period falling on or after 5 December 2013 are to be excluded from the CFC’s qualifying loan relationship profits.

BACKGROUND NOTE

18. The CFC rules at Part 9A TIOPA (introduced in Finance Act 2012) better reflect the way that businesses operate in a global economy whilst maintaining protection against artificial diversion of UK profits. This Schedule amends Chapter 9 of Part 9A in order to ensure the CFC rules operate as intended and continue to protect the UK's corporation tax base.

19. If you have any questions about this change, or comments on the legislation, please contact Paul Croasdale on 03000 585572 (email: paul.croasdale@hmrc.gsi.gov.uk).