HM Revenue & Customs

Corporation Tax: 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

This measure ensures that changes to accounting standards do not create unintended additional Corporation Tax liabilities under the provisions of the worldwide debt cap (WWDC).

Policy objective

The WWDC broadly limits the Corporation Tax 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.

This measure amends the WWDC rules to ensure that they continue to operate in line with the policy intention and the changes to accounting standards do not result in additional disallowances of financing expenses.

Background to the measure

The debt cap rules were introduced in Finance Act 2009. Under the rules the net finance expenses of the UK members of a group are compared with the gross finance costs of the worldwide group as a whole. Where the net UK expenses are greater than the gross group costs, the excess is disallowed.

The gross finance expenses of the group are calculated by reference to amounts contained in the consolidated financial statements of the group prepared using either International Accounting Standards (IAS) or UK Generally Accepted Accounting Principles (GAAP).

International Financial Reporting Standard 10 (IFRS 10) is the IAS setting out the principles for presenting and preparing consolidated financial statements when an entity controls one or more entities. IFRS 10 was amended in 2012 and the amendments apply mandatorily for periods of account beginning on or after 1 January 2014. Early adoption is possible. Large and medium companies which do not apply IFRS are affected by an equivalent change to UK GAAP for accounting periods beginning on or after 1 January 2015.

As a result of these amendments, the debt cap computations may produce increased disallowances of finance expenses where the parent company of a group is an 'investment entity'. An investment entity is, in essence, one that holds investments for investors and where the performance of its investments is measured on a fair value basis.

Detailed proposal

Operative date

This measure has effect for accounting periods for which a company adopts the accounting changes referred to above which result from amendments to IAS or UK GAAP. These include accounting periods which start before 2 April 2015, the date on which the change comes into force.

Current law

Part 7 of the Taxation (International and other Provisions) Act 2010 (TIOPA) contains the WWDC rules. Chapter 10 of part 7 TIOPA defines 'financial statements of the worldwide group' as the consolidated statements of the ultimate parent and its subsidiaries. It also makes provision for circumstances in which financial statements of the worldwide group are not drawn up. It does not, however, cater for all situations and, without this change, there will be some finance expenses which are taken into account in computing a company's Corporation Tax liability where no corresponding amount is reflected in the group financial statements. This would give rise to an unintended disallowance of a deduction for such a finance expense.

Section 353AA TIOPA contains the regulation-making power for regulations to take account of accounting changes resulting from a change in accounting standards.

Proposed revisions

The change increases the measure of a worldwide group's gross finance costs by certain amounts relating to funding from sources external to the worldwide group. These are amounts which are taken into account in the calculation of a UK company's net finance expenses or income, but not in the amount of gross finance costs of the group as a whole for the purposes of the debt cap calculations, because of the effect of the changes to IAS and GAAP.

Summary of impacts

<table>
<tr><td rowspan="3">Exchequer impact (£m)</td><td>2015 to 2016</td><td>2016 to 2017</td><td>2017 to 2018</td><td>2018 to 2019</td><td>2019 to 2020</td></tr>
<tr><td>nil</td><td>nil</td><td>nil</td><td>nil</td><td>nil</td></tr>
<tr><td colspan="5">This measure is not expected to have an Exchequer impact.</td></tr>
<tr><td>Economic impact</td><td colspan="5">This measure is not expected to have any significant economic impacts.</td></tr>
<tr><td>Impact on individuals, households and families</td><td colspan="5">The measure will not have any impact on individuals and households as it relates to large groups of companies that are subject to the debt cap.

The measure is not expected to impact on family formation, stability or breakdown.</td></tr>
<tr><td>Equalities impacts</td><td colspan="5">The measure is not expected to have any equalities impact.</td></tr>
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Impact on business including civil society organisations	The debt cap rules only apply to large corporate groups, of which we estimate there are 1,800. Civil society organisations will be unaffected by these changes. For the large corporate groups affected there will be a positive impact as the changes to accounting standards will not create or increase any disallowance of finance expenses under the debt cap provisions. This measure is expected to have no impact on businesses or civil society organisations in terms of one-off and on-going administrative costs.
Operational impact (£m) (HMRC or other)	It is not anticipated that implementing this change will incur any additional costs or savings for HM Revenue and Customs.
Other impacts	Small and micro business assessment: small and micro businesses will not be affected by these changes. 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 Telephone: 03000 585712 (email:judith.diamond@hmrc.gsi.gov.uk).

Declaration

David Gauke MP, Financial 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.