Clause 1 and Schedule 1: Corporate interest restriction

Summary

1. This measure introduces a restriction on the amount of interest and other financing amounts that a company may deduct in computing its profits for corporation tax purposes. The legislation takes effect from 1 April 2017.

Details of the clause and schedule

2. Clause 1 introduces Schedule 1.

Schedule 1

Part 1: New Part 10 of TIOPA 2010

3. Part 1 of Schedule 1 introduces a new Part 10 into the Taxation (International and Other Provisions) Act 2010 (TIOPA). In consequence, the existing Part 10 of TIOPA is renumbered as Part 11, and certain further consequential changes are made (see paragraph 21 in Part 3 of the schedule).

Chapter 1: Introduction

4. New Section 372 sets out an overview of the new Part 10 and provides brief details about the contents of each Chapter; and of new Schedule 7A of TIOPA, which contains administrative provisions. Chapters 2 to 5 contain the main rules by which any interest restriction is calculated. In particular, section 372(4) introduces key terms defined in Chapter 3 involving "tax-interest". This is a company's or group's interest and similar amounts which are included in the UK tax computations. These are the amounts that are potentially restricted under these provisions.

5. Chapters 6 and 7 define key concepts. In particular, section 372(7) and 372(8) introduces key terms defined in Chapters 6 and 7 involving "tax-EBITDA". This is a company's or a group's taxable earnings before interest tax depreciation and amortisation, and is an important part of the calculation of an interest restriction. These are the amounts that form the basis of the worldwide group's interest capacity for the period, and hence determine the amount of tax-interest amounts that may be deducted.

6. New section 373 sets out the meaning of certain terms used in the new Part 10. Those terms are described by reference to a "period of account" for a "worldwide group".

Throughout this legislation "period of account" is used to describe the period by reference to which the group draws up its accounts. That period may not necessarily match the accounting periods used by some of the companies within the group. The term "accounting period" is used to refer to the period by reference to which a company computes its profits chargeable to UK corporation tax.

7. New Section 374 introduces new Schedule 7A of TIOPA. This schedule contains administrative provisions including the interest restriction return, enquiry powers and information powers.

Chapter 2: Disallowance and reactivation of tax-interest expense amounts

8. New Section 375 sets out how tax deductions are disallowed where a full interest restriction return is submitted (section 376 covers the situation where only an abbreviated return, or no such return, is submitted). Section 375(2) specifies that a company must disallow deductions in the amounts set out in the return. There is further provision in section 377 as to which deductions must be disallowed.

9. Section 375(3)-(5) covers the situation where a non-consenting company does not give its agreement (or withdraws its agreement) to be bound by the amount allocated to it in the return (a "non-consenting company", as defined in paragraph 7 of Schedule 7A). This might be the case if it disagrees with the way the amount to be allocated has been calculated. In such a case, the company must disallow a pro-rated amount as allocated to the accounting period under paragraph 20 of Schedule 7A. The distinction between consenting and non-consenting companies is made to help the group manage possible conflicts of interest where a member of the group has a significant shareholder who holds a minority interest in the company, or where insolvency arrangements come into effect.

10. New Section 376 sets out how tax deductions are disallowed where only an abbreviated interest restriction return, or no such return, is submitted (section 375 covers the situation where a full return is submitted). This paragraph takes effect after 12 months have elapsed from the end of the period of account. Section 376(5) specifies that a company must disallow deductions in any accounting period in accordance with the amount of disallowance due to it under the pro-rating rules in paragraph 20 of Schedule 7A.

11. New Section 377 sets out how to identify the amounts to be restricted under sections 375(2), 375(5) or 376(5). Section 377(2) sets out the default order in which amounts are disallowed. Section 377(3) allows a company to elect out of the default order and choose what tax-interest expense amounts it disallows.

12. New Section 378 provides that any deduction that has been disallowed under sections 375 and 376 may be carried forward to a later period where it may potentially be the subject of a "reactivation". Section 378(3) stops the carry-forward of disallowed trading expenses once the company ceases to trade or the trading

activities have become small or negligible. Section 378(4)-(5) applies in a similar way where the trade becomes uncommercial and is not carried on in the exercise of a statutory function (within the meaning of section 44 of CTA 2010). Section 378(7) specifies, for the avoidance of doubt, that if a disallowed deduction is reactivated and allowed in a subsequent period, then it is extinguished and cannot be carried forward again.

13. New Section 379 provides for disallowed amounts to be reactivated and allowed in later periods. Section 379(1) allows the reactivation of amounts brought forward only in a period for which a full interest restriction return has been submitted (see paragraph 16 of Schedule 7A) and where that return includes a statement of allocated interest reactivations (see paragraph 16(2)(f)(iii) of Schedule 7A). Section 379(2)-(4) requires a company that has an accounting period to which a reactivation is allocated to give effect to that allocation.

14. New Section 380 sets out the amounts to be reactivated by a company when required to do so under section 379. Section 380(2) sets out the default order in which amounts are reactivated where the company does not exercise its right to choose. Section 380(3) allows a company to elect out of the default order and choose what tax-interest expense amounts it reactivates. Section 380(4) specifies that the tax-interest expense amounts reactivated are included in the company's election.

15. New Section 381 covers the uncommon situation where a company, in relation to one of its accounting periods, must disallow a deduction of that period and also bring into account some reactivated deduction carried forward from an earlier period. The amounts of disallowance and reactivation must in effect be set off against each other, with only the net result being given effect.

Chapter 3: Tax-interest amounts

16. New Section 382 sets out the meaning of the term "tax-interest expense amount" by reference to three conditions, only one of which needs to be met to satisfy the definition. In particular the amount must be a relevant loan relationship debit (section 383), a relevant derivative contract debit (section 384) or a financing cost implicit in amounts payable under a relevant arrangement, which includes finance leases, debt factoring and service concession arrangements accounted for as a financial liability (section 382(5)).

17. Section 382(7) onwards sets out the treatment of a "disregarded period", which is where the company's accounting period does not exactly align with the group's period of account. Amounts are attributed to the disregard period on a just and reasonable basis, for example having regard to:

- The period in which amounts would be recognised in the company's financial statements if they were drawn up for particular periods.

- The period in which amounts would be brought into account by the company if it had a different accounting period.

- Ensuring that the amounts are in total fully attributed. In other words, if the accounting period is broken up into a number of periods which do not overlap and which taken together completely align with the accounting period in question that the total of the amounts attributed to those periods equals the amount being attributed.

18. New Section 383 sets out the meaning of "relevant loan relationship debits". These are debits brought into account under the loan relationship provisions provided they are not excluded debits. A debit will be excluded if it is in respect of an exchange loss or impairment loss.

19. New Section 384 sets out the meaning of "relevant derivative contract debits". These are certain debits brought into account under the derivative contract provisions, depending on the underlying subject matter of the derivative. A debit will be excluded if it is in respect of an exchange loss or impairment loss or arises in the course of a trade involving dealing in derivative contracts (in line with the type of trading activities undertaken by a bank).

20. New Section 385 sets out the meaning of "tax-interest income amounts" by reference to four conditions, only one of which needs to be met to satisfy the definition. In particular the amount must be a relevant loan relationship credit (section 386), a relevant derivative contract credit (section 387), a financing cost implicit in amounts receivable under a relevant arrangement which includes finance leases, debt factoring and service concession arrangements accounted for as a financial asset, (section 385(5)) or an amount receivable for providing a guarantee (section 385(6)).

21. Section 385(8) onwards set out the treatment of a "disregarded period" which is where the company's accounting period does not exactly align with the group's accounting period. Amounts are attributed to the disregard period on a just and reasonable basis, for example having regard to:

    - The period in which amounts would be recognised in the company's financial statements if they were drawn up for particular periods.
    - The period in which amounts would be brought into account by the company if it had a different accounting period.
    - Ensuring that the amounts are in total fully attributed. In other words, if the accounting period is broken up into a number of periods which do not overlap and which taken together completely align with the accounting period in question that the total of the amounts attributed to those periods equals the amount being attributed.

22. New Section 386 sets out the meaning of "relevant loan relationship credits". These

are credits brought into account under the loan relationship provisions provided they are not excluded credits. A credit will be excluded if it is in respect of an exchange gain or reversal of an impairment loss.

23. New Section 387 sets out the meaning of "relevant derivative contract credits". These are certain credits brought into account under the derivative contract provisions, depending on the underlying subject matter of the derivative. A credit will be excluded if it is in respect of an exchange gain or reversal of an impairment loss or arises in the course of a trade involving the dealing in derivative contracts (in line with the type of trading activities undertaken by a bank).

24. New Section 388 provides for double taxation relief. It does this by excluding from the "tax-interest income amount" any amount to the extent it consists of "notional untaxed income". The paragraph sets out the formula used to calculate this amount, which is the item of income, multiplied by the corporation tax payable on it after double tax relief and divided by the corporation tax payable before such credit.

25. New Section 389 sets out the meaning of the "net tax-interest expense" and "net tax-interest income" of a company. These are calculated by comparing the company's "tax-interest income amounts" (section 385) with its "tax-interest expense amounts" (section 382).

26. New Section 390 sets out the meaning of the worldwide group's "aggregate net tax-interest expense" and "aggregate net tax-interest income". These are the difference between the sum of each relevant company's "net tax-interest expense amount" and the sum of its "net tax-interest income amount" for the period.

27. New Section 391 sets out the meaning of "impairment loss". This is important for looking at which credits and debits are excluded from the definition of "tax-interest" (see, for example, section 383(3)(b)).

Chapter 4: Interest Capacity

28. New Section 392 defines the "interest capacity" of a worldwide group for a period of account. Interest capacity is the aggregate of the interest allowance of the period and any unused interest allowance carried forward from an earlier period that is available in the current period. However this is subject to a *de minimis* amount of £2m per annum if that gives a bigger capacity. "Interest allowance" is defined in Chapter 5 of Part 10.

29. New Section 393 sets out how much interest allowance of a period ("the originating period") is available in a later period for the group. It is nil if a full interest restriction return has not been submitted for the period of account (section 393(5)). Otherwise it is the lower of two amounts: A and B:

    - "A" is a measure of how much interest allowance is available because it has not yet been used up. See section 394.

- "B" is a measure of how much interest allowance is available because it has not yet expired (the carry-forward of unused interest allowance is subject to a five year time limit). See section 395.

30. New Section 394 determines the extent to which interest allowance is "used", for the purpose of calculating of how much interest allowance of an originating period is available in a later period. Interest allowance is 'used' where it allows the group to obtain a deduction for tax-interest amounts. Section 394(2) sets out how much interest allowance is used in the originating period, and section 394(3)-(5) sets out how much interest allowance of the originating period is used in a later "receiving" period. The lower of these two amounts is the amount of interest allowance that has been "used".

31. Section 394(3) sets out the amount of the interest allowance from the originating period that is used in a receiving period. It is the amount calculated in section 394(4), but this is limited so that it cannot exceed the total amount of the allowance from the originating period that is available in the receiving period (section 394(5)).

32. Section 394(4) defines "the relevant part of the aggregate net tax-interest expense of the group for the receiving period". This is the amount of the interest expense of the receiving period that is not covered or franked by either: (i) the interest allowance of the receiving period; or (ii) the interest allowance of any period that is earlier than the originating period, that is carried forward and used in the receiving period. It is therefore the amount of the interest expense of the receiving period left over that can consume the interest allowance carried forward from the originating period.

33. The formula used can give a negative amount where the amount of interest allowance of the receiving period exceeds the aggregate net tax-interest of the receiving period. In such a case, the amount calculated is set to nil by section 394(5).

34. New Section 395 determines the extent to which interest allowance is "unexpired", for the purpose of calculating of how much interest allowance of an "originating period" is available in a later period under section 393. The rules set out how the five year limit for carrying forward unused interest allowance should be applied. Section 395(2) and (3) sets out the circumstances where, respectively, all or none of the interest allowance of the originating period is unexpired in a later "receiving period". The remainder of the section deals with situations where part is unexpired.

35. Section 395(4), (6), and (8) describes three different scenarios. There is a different result for each scenario, as laid out respectively in section 395(5), (7) and (9). Note that that the result in Section 395(9) is the lower of the amounts given by section 395(5) and 395(7).

36. To understand the different scenarios, it can be helpful to think of the notional period that would result from moving the originating period forward five years.

- Section 395(4): the receiving period falls entirely within the notional period.

- Section 395(6): the notional period falls entirely within the receiving period.
- Section 395(8): the receiving period overlaps the notional period, but starts after the notional period starts and ends after the notional period ends.

37. Section 395(5) determines the amount of interest allowance for the originating period that is unexpired in the receiving period where section 395(4) applies. This is an amount equal to the interest allowance of the originating period to the extent (if any) that it exceeds the aggregate net tax-interest expense for the originating period, reduced by a fraction. The fraction is the number of days in the notional period that fall after the start of the receiving period, divided by the total number of days in the originating period. This effectively expires the amount of interest allowance generated in the part of the originating period that falls more than five years before the receiving period starts.

38. Section 395(7) determines the amount of interest allowance for the originating period that is unexpired in the receiving period where section 395(6) applies. In the circumstances described in section 395(6), all of the interest allowance from the originating period is "in time" to be used for the start of the receiving period. However not all of the interest expense in the receiving period can access the allowance. So section 395(7) prevents the inappropriate set off of interest allowance from the originating period against interest expense that arises more than five years after the originating period ends. This is achieved by looking at the aggregate net tax-interest expense in the receiving period to the extent it exceeds the interest allowance of that period, and excluding on a pro-rata basis the expense that arises more than five years after the originating period ends

39. The amount calculated under section 395(7) is equal to the aggregate net tax-interest expense of the receiving period to the extent (if any) that it exceeds the interest allowance for the receiving period, reduced by a fraction. The fraction is the number of days in the receiving period that fall before the end of the notional period, divided by the total number of days in the receiving period.

40. The calculation could give an amount that exceeds the total interest allowance of the originating period. However, the calculation can never lead to an inappropriately large amount of interest allowance being available in a later period because of the way it feeds into section 393(4) and then section 393(2), which will ensure that the amount available cannot exceed the total amount of interest allowance for the originating period.

41. Section 395(9) determines the amount of interest allowance of the originating period that is unexpired in the receiving period where section 395(8) applies. In this case only part of the interest allowance from the originating period is in time and only

part of the interest expense of the receiving period is in time. Both partial amounts must therefore be calculated (the partial amount of interest allowance under section 395(5) and the partial amount of interest expense under section 395(7)) and the lower amount used.

Chapter 5: Interest Allowance

42. New Section 396 defines the interest allowance for a period of account as, by default, the amount given by the "fixed ratio method" (section 397) or, by election, the amount given by the "group ratio method" (section 398). In addition, where in a period a group has an aggregate net tax-interest income then this is added to the interest allowance for the period.

43. New Section 397 sets out the calculation of the interest allowance by the fixed ratio method. It is the lower of two amounts. The first is 30% of a measure of the group's aggregate tax-EBITDA. The second is a cap based on the "adjusted net group-interest expense" of the group (defined at section 406).

44. New Section 398 sets out the calculation of the interest allowance by the group ratio method. It is the lower of two amounts. The first is a proportion ("the group ratio percentage") of a measure of the group's taxable earnings. The second is a cap based on the "qualifying net group-interest expense" of the group (see section 410), the calculation of which differs from the cap in section 397.

45. Section 398(3) and (4) sets out how the group ratio percentage is determined. It is the ratio of a measure of the worldwide group's interest expense to a measure of its worldwide earnings. It is set to 100% where it would otherwise be higher, negative or the formula for calculating it would be mathematically undefined.

46. New Section 399 sets out the consequences of making a "group ratio (blended) election" in accordance with paragraph 11 of Schedule 7A. This election allows a group to calculate its group ratio percentage with reference to the group ratio percentage of one or more related party investors. In this case the group ratio percentage is determined by calculating a weighted average of the applicable percentages for each investor. Each applicable percentage is the highest of 30%, the ratio for the group calculated in accordance with section 398, and (if the investor is a member of a separate worldwide group) the group ratio for that investor's group. Each applicable percentage is weighted by that investor's interest in the group. Section 399(5) and (6) is used where the relevant periods of account of an investor overlap the relevant period of account of the worldwide group.

47. New Section 400 defines "investor", "related party investor" and investor's "share" for the purposes of the interest restriction rules.

Chapter 6: Tax-EBITDA

48. New Section 401 sets out the meaning of the key term "aggregate tax-EBITDA" for the worldwide group in respect of a period of account. This total is used in sections 397 and 398 in determining any restriction under the fixed ratio method and the

group ratio method.

49. New Section 402 sets out the meaning of "tax-EBITDA" for an individual company in respect of a period of account. In particular, it identifies particular amounts in respect of the period of account in question. The resultant amounts form the basis for the calculation of aggregated tax-EBITDA in section 401.

50. The amounts are identified through satisfying either condition A or condition B. Condition A covers amounts that are brought into account by the company in determining its taxable profits for the period. Condition B extends this to also include amount that would be so brought into account if they company had sufficient taxable profits in the period. This ensures that amounts leading to a tax loss for the period are included in the definition. Tax-EBITDA can be a positive or negative amount for a particular company. Certain amounts are excluded from conditions A and B (see section 403).

51. Section 402(5) to 402(8) also sets out the rules for calculation where the company does not have a single, complete accounting period which coincides with the period of account of the worldwide group. Amounts are attributed to the disregard period on a just and reasonable basis, for example having regard to:

- The period in which amounts would be recognised in the company's financial statements if they were drawn up for particular periods.
- The period in which amounts would be brought into account by the company if it had a different accounting period.
- Ensuring that the amounts are in total fully attributed. In other words, if the accounting period is broken up into a number of periods which do not overlap and which taken together completely align with the accounting period in question that the total of the amounts attributed to those periods equals the amount being attributed.

52. New Section 403 provides details of the amounts to be excluded in arriving at a company's tax-EBITDA figure for a period of account. In particular, it excludes:

- Tax-interest income and tax-interest expense amounts (as defined in Chapter 3 of Part 10).
- Allowances and charges in connection with capital expenditure under the Capital Allowances Act 2001.
- Certain amounts of intangibles debits under the Intangible Fixed Asset rules (Part 8 of the Corporation Tax Act 2009) which relate to amounts capitalised in the company's accounts, and credits representing the reversal of such amounts.

- Losses (such as trading losses, property losses, losses on the disposal of shares, miscellaneous losses, non-trading losses on intangible fixed assets, but excluding capital losses), non-trade loan relationship deficits, management expenses from an earlier or later accounting period.
- Group relief (including consortium relief) except to the extent of any claim of group relief from a company outside of the group. This includes amounts of losses brought forward that are surrendered under section 188CK of CTA 2010.
- Amounts of qualifying tax reliefs (as specified in section 403(3)).

53. Tax-EBITDA is to be calculated on the basis of including net chargeable gains under the Taxation of Chargeable Gains Act 1992. As a result, section 403(4) provides that capital losses are only taken into account in the period in which they are actually deducted from a chargeable gain.

54. New Section 404 provides further interpretation for the purposes of section 403 in respect of the treatment of intangible fixed assets. This specifies certain debits arising in respect of intangible fixed assets which are always excluded from tax-EBITDA. It also specifies certain debts and credits in respect of intangible fixed assets which are excluded to the extent that they reflect debit and credit amounts that would have been excluded previously.

55. New Section 405 adjusts for circumstances where the corporation tax charge is reduced by reason of a credit for foreign tax. An amount derived by the formula at section 405(3) is treated as 'notional untaxed income' (as in the calculation of tax-interest income, see section 388) and will not form part of the company's adjusted corporation tax earnings within section 402(2).

Chapter 7: Group-interest and group-EBITDA

56. New Section 406 sets out the meaning of "the net group-interest expense" of a worldwide group for a period of account. This comprises the amounts in respect of "relevant interest expense matters" and "relevant interest income matters" as recognised in the group's financial statements as items of profit or loss for the period.

57. Section 406(2) to 406(5) ensure that amounts are included in net group-interest expense where the amounts are capitalised in respect of an asset that is not a relevant asset and the cost of the asset is expensed or otherwise written off (for example as part of cost of sales). Amounts in respect of a relevant asset are not included to avoid amounts being included in both net group-interest expense and as part of the depreciation and amortisation adjustment. This ensures that group-EBITDA is calculated correctly (see section 411).

58. New Section 407 sets out the meaning of "relevant expense matters" and "relevant income matters". This aims to mirror the types of item that would be included within

the scope of tax-interest expense amounts (see section 382), and tax-interest income amounts, (see section 385). So, for example, it includes amounts which are loan relationships of a company within the group and also specific arrangements that would be treated as loan relationships of a company under UK tax rules.

59. New Section 408 provides further interpretation for the purposes of section 407.

60. New Section 409 sets out the meaning of "adjusted net group-interest expense" of a worldwide group for a period of account. This is based on the net group-interest expense of the group, adjusted for certain items.

- Section 409(3)(a), 409(3)(b), 409(4)(a) and 409(4)(b) makes adjustments for amounts of interest and other items that are capitalised in the carrying value of an asset or liability of the company. These ensure that capitalised interest is included in adjusted net group-interest expense at the time it is capitalised and excluded at the time it is expensed in profit or loss.
- Section 409(3)(c) and 409(4)(c) makes adjustments for amounts in respect of debt releases and modifications of debt that would be excluded from tax under sections 322 and 323A of the Corporation Tax Act 2009.
- Section 409(4)(d) makes adjustments to exclude amounts of dividends payable on preference shares that are recognised as a liability in the group's financial statements.

61. New Section 410 sets out the meaning of qualifying net group-interest expense. This is based on the adjusted net group-interest expense of the group, were the following non-qualifying amounts of interest expense to be excluded.

- Section 410(3)(a) excludes amounts arising on financial liabilities owed to related parties.
- Section 410(3)(b) excludes amounts arising on results dependent securities.
- Section 410(3)(c) excludes amounts arising on perpetual and very long-dated instruments.

62. New Section 411 sets out the meaning of "group-EBITDA". This is based on the profit of the worldwide group recognised in its consolidated financial statements, before the inclusion of amounts relating to interest, taxation, depreciation and amortisation. This is based on the following concepts:

- Profit (or loss) before tax (PBT) is based on the consolidated statements as the profit for the period before taxation.

- Net group-interest expense (I) is the amount defined at section 406.
- Depreciation and amortisation adjustment (DA) is the aggregate of three adjustments to remove depreciation and amortisation, as well as revaluation movements. It also recomputes any profit or loss arising on the disposal of the asset in question.

63. New Section 412 sets out the meaning of the 'capital (expenditure) adjustment'. This adjustment removes amounts of capital expenditure on relevant assets from group-EBITDA. This will typically be amounts of depreciation and amortisation, but also includes for example amounts written off as incurred.

64. It also excludes income amounts of a capital nature relating to relevant assets. In particular, this will exclude income recognised in respect of contributions received towards the costs of capital expenditure incurred by the group.

65. Relevant assets are defined at section 412(5) as comprising (i) plant, property and equipment; (ii) intangible assets; (iii) goodwill; (iv) shares in a company; and (v) interests in an entity which entitle the holder to a share of profits.

66. New Section 413 sets out the meaning of the 'capital (fair value movement) adjustment'. This adjustment removes revaluations and other fair value movements in respect of relevant assets from group-EBITDA.

67. New Section 414 sets out the meaning of the 'capital (disposals) adjustment'. This adjustments removes the actual profit or loss recognised in respect of relevant assets from group-EBITDA and replaces it with a recomputed profit on disposal. This is calculated disregarding any amounts of written off or any revaluation adjustments. As such it calculates the profit on assumption that the asset it question was not depreciated or amortised, and was not revalued. In most cases this should be the actual proceeds from the disposal less the actual cost of acquiring the asset.

68. New Section 415 deals with derivative contracts that are recognised at fair value in the accounts. This applies the effect of regulations 7, 8, 9 and 10 of the Disregard Regulations (S.I. 2004/3256) to the calculation of amounts of group-interest and group-EBITDA. As such, it removes the fair value movements arising from derivative contracts in particular circumstances where they form part of an intended hedge. Instead, amounts under the derivative contract will be recognised into the calculation of group-interest and group-EBITDA in line with the hedged item.

69. New Section 416 adapts the computation under section 409 when an interest allowance (alternative calculation) election has effect (see paragraph 9 of schedule 7A). This turns off the basic rules at section 409 in respect of amounts capitalised where the member of the group in question calculates (or would calculate if it were within the charge to Corporation Tax) the taxable profits from the asset in line with its accounting value. In particular, this will typically be the case in respect of interest capitalised as part of items of trading stock. This aligns the calculation of group-

interest with the operation of sections 320 and 604 of CTA 2009.

70. New Section 417 adapts the computation of relevant gains and losses on relevant assets under section 414 when an interest allowance (alternative calculation) election has effect (see paragraph 12 of schedule 7A). This calculates the profit or loss on disposal of the asset in line with the provisions of TCGA 1992 on the assumption that all members of the group are within the charge of Corporation Tax. However, in making this calculation no benefit is taken of the Substantial Shareholdings Exemption or of Double Taxation Relief.

71. New Section 418 adapts the computation under section 411 in relation to employers' pension contributions into a registered pension scheme when an interest allowance (alternative calculation) election has effect (see paragraph 12 of schedule 7A). This replaces the accounting entries in respect of the registered pension scheme with the amounts that would fall to be deductible under sections 196 to 200 FA 2004. Typically amounts would therefore be included on a paid basis. However, a different basis may be required for example where the amounts are being spread under section 197 FA 2004.

72. New Section 419 adapts the computation under section 411 in relation to employees' share acquisition arrangements when an interest allowance (alternative calculation) election has effect (see paragraph 12 of schedule 7A). This replaces the accounting entries in respect of employee share schemes which fall (or would fall) within Part 11 or Part 12 of CTA 2009, with the amounts that would fall to be deductible under those provisions. This applies on the assumption that all members of the group are within the charge of Corporation Tax

73. New Section 420 applies when there is a change of accounting policy where an interest allowance (alternative calculation) election has effect (see paragraph 12 of schedule 7A). This applies where there has at any time been a change on the accounting policy in the financial statements of the worldwide group. Where relevant, the tax provisions relating to changes of accounting policy are applied in the context of the worldwide group (ie: on the assumption that the worldwide group was a single company within the charge to Corporation Tax).

74. New Section 421 amends certain definitions where an interest allowance (non-consolidated holdings) election has effect (see paragraph 13 of schedule 7A). This election amends the financial statements of the worldwide group in respect of the worldwide group interest in an associated world group (for example, as investment in a joint venture). This election allows the principal worldwide group to include an appropriate proportion of the qualifying net group interest expense for an associated group to its adjusted net group interest expense and its qualifying net group interest expense. The group-EBITDA of the principal worldwide group is also increased by the proportion of the group-EBITDA for the associated worldwide group.

75. New Section 422 provides further interpretation for the purposes of section 421.

76. New Section 423 provides the meaning of "non-consolidated associate" used in

section 421. This defines a non-consolidated associate as an entity being accounted for in the financial statements as a joint venture or an associate using the equity or gross method of accounting or a partnership that has elected into the interest allowance (consolidated partnership) election.

77. New Section 424 adapts the computation when an interest allowance (consolidated partnerships) election has effect (see paragraph 14 of schedule 7A). This has the effect of taking the items of profit or loss out of the financial statements of the worldwide group in respect of the consolidated partnership, and instead uses the equity method of accounting to adjust the financial statements of the worldwide group. This section also defines a consolidated partnership.

78. New Section 425 sets out additional interpretation for the Chapter about the meaning of amounts recognised as items of profit or loss, or as items of other comprehensive income.

Chapter 8: Public infrastructure

79. New Section 426 sets out an overview of the Chapter, which provides for the corporate interest restriction to have an altered effect for "qualifying infrastructure companies". To qualify, a company's income and assets must be referable to activities related to "public infrastructure assets", have comparable levels of debt to other group companies, be fully taxable in the UK and the company must make an election, as explained in sections 427 to 430.

80. Amounts in respect of certain loans and other financial liabilities, if meeting further conditions explained in sections 431 and 432, are excluded from being tax-interest expense amounts. In addition, no amounts of the company are included in tax-interest income amounts and tax-EBITDA for the period. The Chapter also acts to adjust other amounts within the corporate interest restriction.

81. New Section 427 explains the conditions which must be met for a company to be a "qualifying infrastructure company". A company must be fully taxable in the UK and meet the "public infrastructure asset", "public infrastructure income" and "comparative debt" tests throughout an accounting period and make an election to be a qualifying infrastructure company throughout an accounting period.

- The "public infrastructure income" test requires all but an insignificant proportion of a company's income to derive from a "qualifying infrastructure activity", or shares in, or loan relationships or other financing arrangements with "qualifying infrastructure companies";
- The "public infrastructure asset" test requires all but an insignificant proportion of the value a company's assets derive from any of (i) tangible assets, (ii) service concession arrangements relating to a "qualifying infrastructure activity"; (iii) financial assets relating to a "qualifying infrastructure activity" of that company or an associated

"qualifying infrastructure company" ; (iv) shares in a "qualifying infrastructure company" and (v) loan relationships or other financing arrangements to which a "qualifying infrastructure company" is a party. If the "public infrastructure asset" test is failed for less than 5 days in an accounting period, a company may still be a "qualifying infrastructure company" in that period;

- The "comparative debt test" requires the total level of indebtedness of a qualifying infrastructure companies in a group does not exceed that of comparable group entities who carry on similar activities with similar assets (for example in respect of maturity; an asset is likely to have more related debt immediately post construction compared to one near the end of its life).

82. New Section 428 sets out that an election to be a "qualifying infrastructure company" must be made in advance of an accounting period it is to have effect. It can be revoked after a period of five years, but will continue to have effect until the accounting period after a revocation. If a revocation is made, a company's subsequent election cannot have effect for an accounting period which begins after less than five years from the revocation. Transferees in a transfer of a part of a business of a "qualifying infrastructure company" inherit any election made by the transferor. Once an election has been made by a company they cannot make a claim under Chapter 2 of Part 2, or an election under section 18A of CTA 2009.

83. New Section 429 explains that a "qualifying infrastructure activity" is the "provision" of a "public infrastructure asset" or any ancillary/facilitating activities.

- Any tangible asset may be a "public infrastructure asset" if it meets a "public benefit test". That is, the asset is procured by a relevant public body or its use is or could be regulated by an "infrastructure authority".
- Any building may also be a "qualifying infrastructure asset" if it is part of a UK property business, intended to be let on "short-term basis" to persons who are not related parties. "Short-term basis" is set out as having an effective duration of less than 50 years and not being considered a structured finance arrangement.
- A "public infrastructure asset" must have had, has or be likely to have an expected economic life of at least 10 years and be recognised on the balance sheet of a group company subject to corporation tax.
- "Provision" for these purposes includes acquisition, design, construction, conversion, improvement, operation and repair.

84. New Section 430 provides examples of what "infrastructure" might include, and also

what would be considered an “infrastructure authority”.

85. New Section 431 sets out the amounts of interest and similar financial expense which may be excluded from tax-interest expense. These are amounts in relation to a financial liability due to an unrelated party or to another qualifying infrastructure company, and amounts in relation to a “qualifying old loan relationship”. In all cases amounts in respect of a financial liability cannot be excluded unless the creditor’s recourse is limited to the income and assets of, or the shares in a qualifying infrastructure company. Guarantees, indemnities or other financial assistance are ignored for the purposes of considering recourse where provided by a relevant public body or a person not related to the company.

86. New Section 432 explains that a “qualifying old loan relationship” is a loan relationship entered into on or before 12 May 2016, where, at that date, at least 80% of the present value of the borrowing company’s future “qualifying infrastructure receipts” for a period of at least 10 years are highly predictable by reference to “qualifying public contracts”. It must also meet the creditor’s recourse conditions in section 431. Amendments to a “qualifying old loan relationship” after 12 May 2016 are treated as having no effect for the purposes of section 431. If at any point after 12 May 2016 the company does not hold assets which, as at 12 May 2016 would pass the 80% present value condition, the loan relationships of the company can no longer be a “qualifying old loan relationship” from that point onwards.

    a. “Qualifying infrastructure receipts” are both receipts arising from “qualifying infrastructure activities” carried on by a company and a “qualifying infrastructure company” it holds shares in or has lent to.

    b. “Qualifying public contracts” are contracts with a relevant public body, or entered into following a tendering or procurement exercise ran by one.

87. New Section 433 provides that if in an accounting period a company is a “qualifying infrastructure company” it is treated as having no “tax-interest income amounts” in that period.

88. New Section 434 provides that if in an accounting period a company is a “qualifying infrastructure company” it has a “tax-EBITDA” of nil for that period.

89. New Section 435 provides that if in an accounting period a company is a “qualifying infrastructure company”, exempt amounts must be excluded from “net-group interest expense” and “qualifying net group-interest expense” of the worldwide group for that period. Similarly the “EBITDA” of the worldwide group is to be calculated as if the “qualifying infrastructure company” is not included.

90. New Section 436 applies in an accounting period where a worldwide group with a “qualifying infrastructure company” would be subject to interest restrictions unless the “de-minimis” is available. This Part requires a company with such a “qualifying interest company” (i.e. applying Chapter 8) to calculate its interest capacity as if the “de-minimis” was not available. An exception is provided where the total interest

restrictions would exceed those which would arise if Chapter 8 did not apply and the “de-minimis” was available.

91. New Section 437 provides that the Chapter can apply to the “decommissioning” of a “public infrastructure asset” as well as the “provision” of one. It also provides that in considering whether a company is a “qualifying infrastructure company”, shares in or any loan relationship or other financing arrangement with a “decommissioning fund” can be ignored. A “decommissioning fund” is a company which holds investments for the sole purpose of funding decommissioning of public infrastructure assets and is prevented from using the proceeds for any other purpose.

92. New Section 438 sets out some definitions for the purposes of the Chapter.

Chapter 9: Cases involving particular types of company or business

93. New Section 439 provides specific exemption from the interest restriction calculation of oil and gas ring-fence activities within the meaning of section 275 of CTA 2010.

94. New Section 440 provides special rules for Real Estate Investment Trusts (REITs). This imports the deeming that the exempt property rental business and the residual business of the REIT are to be regarded as separate companies. In addition the profits of the property rental business are assumed not to be exempted from Corporation Tax for the purposes of calculating tax-interest and tax-EBITDA. It specifies how the restricted interest should be allocated between these two businesses and allows for excess amounts to be carried forward in accordance with the rules in Chapter 2. These streamed amounts are then to be included within an interest restriction return.

95. New Section 441 provides special rules for investments held by insurance companies as part of a portfolio. Where such an investment would otherwise be a subsidiary that would be part of the insurer’s worldwide group, this provision will ensure that this does not happen. In such a case the subsidiary is not considered to be a consolidated subsidiary of any member of the worldwide group of the insurer. This allows the subsidiary to form its own worldwide group separate from the insurance company’s group.

96. New Section 442 provides an option by way of an election for insurers and other companies which hold loan receivables (creditor relationships) at fair value to disapply that treatment and instead apply the corporate interest restriction rules on the basis that the loans had been accounted for on an amortised cost basis of account.

97. New Section 443 supplements section 442. It applies where a company applies an amortised cost basis of accounting in respect of a loan under section 441 and, as a result, this would result in notional debit amounts being included within tax-interest. To facilitate the operation of the disallowance of such amounts, the company concerned must bring into account matching debit and credit amounts equal to the amount of the notional debits. This therefore allows the company to make the disallowance of those debits which would expose the credit as being brought into

account. Otherwise the recognition of the matching debit and credit amounts should leave the company unaffected.

98. New Section 444 applies to certain amounts payable by co-operative societies, community benefit societies, UK agricultural co-operatives or UK fishing co-operatives. Where amounts of distributions are treated as interest under a loan relationship solely by virtue of section 499 of CTA 2009, they are excluded from being a tax-interest expense amount or a tax-interest income amount for the purposes of Part 10 of TIOPA.

99. New Section 445 provides that certain interest payments to charity will be excluded from the "tax-interest expense amount". These are payments made to a charity parent under a loan relationship where the company would be able to claim relief on any donation it made to the parent under section 190 of CTA 2009.

100. New Section 446 makes provision for the calculation of tax-EBITDA in respect of long funding operating leases and finance lease that are not long funding finance leases. This ensure that the treatment of amounts excluded from tax-EBITDA in respect of leases is aligned with the accounting classification of whether a lease is an operating lease or a finance lease, and not based on whether it is a long funding lease or not. This aligns the treatment with the definition of tax-interest which is based on whether a lease is a finance lease.

Chapter 10: Anti-avoidance

101. New Section 447 is an anti-avoidance rule. This applies where there are arrangements that seek to obtain a tax advantage and that tax advantage derives, in whole or in part, from the interest restriction rules. The tax advantage arising from that arrangement is counteracted.

102. Section 447(8) and (9) makes provision so that the regime-wide anti-avoidance rule will not apply to certain 'commercial restructuring arrangements'. This covers cases where loan receivables held offshore are transferred to be within the charge to Corporation Tax. It also covers straight forward restructuring to benefit from the legitimate use of reliefs within the interest restriction rules.

Chapter 11: Interpretation, etc

103. New Section 448 introduces the provisions that specify where a person is a "related party" for the purposes of Part 10 of TIOPA. In particular, it makes it clear that sections 452 and 453 have priority over sections 454 to 456.

104. New Section 449 sets out the main definition of a related party. A person is a related party where (i) they are part of the same consolidated group; (ii) there is common participation in the management, control or capital of the parties; or (iii) the 25% investment condition is met.

105. New Section 450 sets out the meaning of 25% investment in a company or other person.

106. New Section 451 attributes rights and interests when considering where two persons are related parties. In particular, it applies:

- Between connected persons (eg. relatives and companies under common control).
- Between partners in partnership (including through connected persons).
- Between persons where there are arrangements under which a person 'acts together' with another person.
- Between persons where there a 'qualifying arrangement', being an arrangement whereby persons can reasonably be expected to act together to exert greater influence or to achieve a particular outcome.

107. New Section 452 sets out additional cases in which parties are to be considered to be related parties in respect of a particular instrument. Section 452(2) applies where a related party guarantees a particular instrument. Section 452(4) applies where a related party can be seen as the real lender or counterparty by virtue of a series of loan relationships or other arrangements.

108. New Section 453 sets out a further rule that parties are to be considered to be related parties in respect of a particular loan instrument where a number of loan investors also hold equity stakes in a company or other entity in the same, or similar, proportions. This also applies where loans were originally held in such a manner (eg. because they were marketed in this way), even where the loans have since been separated from the equity stakes.

109. New Section 454 sets out a rule under which loans which would otherwise be regarded as being between related parties are not to be so regarded where at least 50% of debt with the same rights is held by unrelated parties.

110. New Section 455 sets out a rule under which loans which would otherwise be treated as being between related parties are not to be so treated where they are made by a bank in the ordinary course of its banking business and the decision of the bank to lend the money was made without regard to the interests which made the bank a related party.

111. New section 456 excludes certain loans made by relevant public bodies (see section 472) from being loans made by a related party for the purposes of this legislation.

112. New Section 457 sets out the meaning of the key terms "worldwide group" and "ultimate parent". To be an "ultimate parent" the entity will need to be a relevant entity which is not a consolidated subsidiary of another relevant entity. The "worldwide group" will then be the ultimate parent and all of its consolidated subsidiaries. This is based on the treatment under International Accounting Standards.

113. New Section 458 sets out the meaning of a "relevant entity" for the purposes of section 453. This covers three categories of entity:

- Condition A covers corporate entities. This does not include Limited Liability Partnerships or foreign partnerships.
- Condition B extends the first category for entities where the members have no automatic entitlement to profits of the entity.
- Condition C extends the first category for entities which have shares or other interests which are listed on a recognised stock exchange and are sufficiently widely held.

114. New Section 459 sets out the meaning of "non-consolidated subsidiary" and "consolidated subsidiary". This provides that a subsidiary company held at fair value (and not consolidated on a line-by-line basis) is a 'non-consolidated subsidiary'. A non-consolidated subsidiary will not be a member of a parent's group. This is based on the treatment under International Accounting Standards.

115. New Section 460 sets out how to determine whether the identity of the worldwide group has changed when the entities which constitute the worldwide group change over time. This is done by reference to who the ultimate parent is at a given point in time.

116. New Section 461 provides for the treatment of "stapled entities". Section 461(3) sets out when an entity is to be treated as "stapled" to another and deems them to be consolidated subsidiaries of another entity.

117. New Section 462 provides for business combinations where, absent this paragraph, two entities would each be treated as an ultimate parent despite their being treated as a single economic entity under international accounting standards. The paragraph has effect as if both entities were consolidated subsidiaries of a deemed parent.

118. New Section 463 sets out the meaning of "financial statements" and "period of account" for a worldwide group. These will be based on the consolidated financial statements for a multi-company worldwide group and on the entity accounts for a single-company worldwide group where these are drawn up and are considered 'acceptable'.

119. New Section 464 explains what is meant by 'acceptable' financial statements and the consequence of such statements not being drawn up for a worldwide group. Acceptable statements are drawn up under International Accounting Standards (IAS), UK generally accepted accounting practice or in accordance of the accounting principles and policies of Canada, China, India, Japan, South Korea or the United States of America. Financial statements that do not materially differ from IAS statements are also acceptable. HMRC may by regulations update the circumstances in which accounts are considered to be 'acceptable'.

120. Where financial statements are drawn up and they are not acceptable, then Part 10 applies on the assumption that IAS financial statements had been drawn up.

121. New Section 465 deals with the case that acceptable financial statements have been prepared but either include the results of companies that are not in the group or do not include the result of companies that are in the worldwide group. This could arise where the accounts are prepared under an accounting framework that differs to IAS. In this case, the accounts are assumed to be prepared so as to be aligned with the composition of the worldwide group, which is defined by reference to IAS (see sections 457 and 458).

122. New Section 466 deals with the case where the ultimate parent prepares accounts for a period and it is not the ultimate parent for the whole of the period. In this case the ultimate parent is treated as if it had instead prepared financial statements for the period for which it was the ultimate of the worldwide group in question.

123. New Section 467 deals with the case where the worldwide group does not prepare consolidated accounts but the ultimate parent does prepare its own financial statements. In this case, IAS accounts are treated as having been drawn up.

124. New Section 468 deals with the case that a multi-company worldwide group does not prepare consolidated financial statements, or a single-company worldwide group does not prepare entity accounts and where section 463 is not relevant. In this case it treats the ultimate parent as preparing financial statements for the period for which no accounts have been prepared. Where this period extends more than 12 months, it is treated as preparing financial statements for each 12 month period.

125. New Section 469 sets out the meaning of “IAS financial statements” of a worldwide group.

126. New Section 470 sets out the meaning of “recognised” in financial statements. This clarifies that where an amount is included as part of another amount which is recognised in the financial statements, than that amount is also regarded as being recognised. In addition, where an amount is expressed in a currency other than sterling then it is to be translated into sterling based on the average rates for the period.

127. New Section 471 sets out the definition of “relevant accounting period”.

128. New Section 472 sets out the meaning of a “relevant public body”. The paragraph lists specific bodies which fall into this definition, but also includes any other body which acts under any enactment for public purposes and not for its own profit. Some of these bodies cannot be a “relevant entity” (see section 458(7)).

129. Section 473 sets out the meaning of a “UK group company”. This covers UK resident companies and non-resident companies which have a permanent establishment in the UK. These are the members of a worldwide group that may be subject to disallowances or reactivations of tax-interest expense amounts.

130. New section 474 contains further interpretation for the Schedule.

131. New Section 475 contains a power to allow HMRC to make regulations in respect of capital market arrangements to allow liabilities of a company to be transferred to another UK group company.

132. New Section 476 contains a power to allow HMRC to make regulations to revise the rules as a result of changes in accounting standards.

133. New section 477 governs the making of regulations under the Schedule, by Statutory Instrument.

Part 2 of Schedule 1: New schedule 7A to TIOPA

134. Schedule 2 inserts a new Schedule 7A into TIOPA. This covers administrative provisions relevant to the interest restriction rules.

Part 1: The reporting company

135. Paragraph 1 of schedule 7A provides for the appointment of a "reporting company" for a period of account by a member of a worldwide group. The appointment must be made after the end of the period of account but no later than six months after the end of that period (paragraph 1(3)). The notice of appointment must be signed by a majority of eligible group members (paragraph 1(4)). The reporting company must be an "eligible company" (paragraph 1(5)).

136. Paragraph 2 of schedule 7A permits HMRC to appoint an eligible company as the reporting company where the members of the worldwide group have not done so.

137. Paragraph 3 of schedule 7A permits HMRC in certain circumstances to appoint a different reporting company, in place of the company appointed under either paragraph 1 or paragraph 2.

138. Paragraph 4 of schedule 7A requires that where a reporting company is appointed for a period of account, it must so notify each company that was a UK group company at any time during the period of account. A UK group company, defined in new section 457 of TIOPA, is a member of the group within the scope of UK corporation tax.

139. Paragraph 5 of schedule 7A requires the reporting company to make an "interest restriction return". This return sets out the amounts of interest and other financing amounts that are to be disallowed or reactivated, and how they are allocated to companies in a group. The time limits for making the return are set out in paragraph 5(5) and 5(6).

140. Paragraph 6 of schedule 7A permits the reporting company to submit a revised interest restriction return, and sets out circumstances where a reporting company must submit a revised interest restriction return.

141. Paragraph 7 of schedule 7A sets out the meaning of a "consenting company" and a "non-consenting company". A "consenting company" is a company in a group that

has agreed to accept the allocation of disallowed amounts made to it in the interest restriction return submitted by the reporting company. All other companies in the group are "non-consenting" companies.

142. Paragraph 8 of schedule 7A provides that if a company is a signatory to the appointment of a reporting company under paragraph 3 it is therefore deemed to be a consenting company, unless it expressly makes a statement to the contrary under paragraph 1(6) when the reporting company is appointed, or revokes its consent by giving a notice under paragraph 7(2)(b).

Part 2: Contents of interest restriction return

143. Paragraph 9 of schedule 7A sets out the elections that must be made in an interest restriction return.

144. Paragraph 10 of schedule 7A permits the reporting company to elect on behalf of the group that the group ratio method should be used to compute the group's interest disallowance.

145. Paragraph 11 of schedule 7A permits the reporting company to elect on behalf of the group that the group ratio method should be used to compute the group's interest disallowance, but subject to the 'blended group ratio provisions' (see section 399).

146. Paragraph 12 of schedule 7A permits the reporting company to elect on behalf of the group that the group ratio method should be used to compute the group's interest disallowance, but subject to the 'alternative calculation provisions' (see sections 416 to 420).

147. Paragraph 13 of schedule 7A permits the reporting company to elect on behalf of the group that the group ratio method should be used to compute the group's interest disallowance, but subject to the 'non-consolidated investment provisions' (see sections 421 and 422).

148. Paragraph 14 of schedule 7A permits the reporting company to elect on behalf of the group that the group ratio method should be used to compute the group's interest disallowance, but subject to the consolidated partnership provisions (see section 424).

149. Paragraph 15 of schedule 7A permits the reporting company to elect to submit an abbreviated return if the worldwide group is not subject to interest restrictions (see paragraph 16(3)).

150. Paragraph 16 of schedule 7A sets out what must be included in an interest restriction return. Paragraph 16(2) sets out the requirements of the full return. Paragraph 16(3) sets out the requirements of an abbreviated return.

151. Paragraph 17 of schedule 7A sets out the detail of the calculations that must be included in a full interest restriction return.

152. Paragraph 18 of schedule 7A sets out what information must be included in a statement of allocated interest restrictions. This statement sets out what amounts of

interest restriction will be applied to each company for the period. This statement must be included in the full return where there are amounts to be restricted for the period.

153. Paragraph 19 of schedule 7A sets out the meaning of a "pro-rata share" of the total disallowed amount for a period of account. This sets the limit on the amounts of disallowance that can be allocated to "non-consenting" companies. It also forms the basis of the amounts to be restricted where no interest restriction return has been submitted. The pro-rata allocation is based on the proportion that a company's net tax-interest bears to the total of the net tax-interest expense amounts across the group for the period of account.

154. Paragraph 20 of schedule 7A sets out how a company allocates a "pro-rata share" to its own accounting periods. The worldwide group's "period of account" used in computing the total disallowance and the allocated shares may not necessarily coincide with the corporation tax accounting period for every company in the group. Apportionment will therefore be necessary.

155. Paragraph 21 of schedule 7A sets out what information must be included in a statement of allocated interest reactivations. An "interest reactivation" arises when an amount disallowed in one period of account could potentially be deductible in a later period of account because the group's tax-EBITDA in that later period is sufficient to permit a deduction of more than the interest arising in that period.

156. Paragraph 22 of schedule 7A sets out how to calculate the amount available for reactivation by a company for a period of account of the group. Any reactivation will take effect in the "specified accounting period", which is the first accounting period that overlaps with the group's period of account in which the company was a part of the group.

157. The starting point ("A") is the total amount that has been disallowed under these rules by that company that is brought forward at the start of the specified accounting period. There are then four possible adjustments in relation to amounts that it must disallow in the current accounting period (amounts B to E). B and C deal with amounts disallowed and reactivated in the specified accounting period in respect of an earlier period of account of the worldwide group. D and E deal with amounts disallowed and reactivated in the specified accounting period in respect of a period of account of another worldwide group before the company joined the worldwide group that is the subject of the reactivation calculation.

158. Paragraph 23 of schedule 7A permits the use of estimated amounts in the interest restriction return if necessary and requires disclosure of the amounts that are estimates.

159. Paragraph 24 of schedule 7A permits HMRC to correct an interest restriction return. The correction must be made no later than 9 months after the day on which the return was submitted.

160. Paragraph 25 of schedule 7A sets out a penalty for failure to deliver an interest restriction return.

161. Paragraph 26 of schedule 7A sets out a penalty for the submission of an incorrect return.

162. Paragraph 27 of schedule 7A sets out what is meant by the term "concealed" for the purposes of paragraph 26. It also extends the meaning of a careless or deliberate inaccuracy to encompass an inaccuracy that is not brought to the attention of an officer of HMRC.

163. Paragraph 28 of schedule 7A provides for a penalty to be imposed on a company that provides inaccurate information to another company for the purposes of an interest restriction return submitted by that other company.

164. Paragraph 29 of schedule 7A provides for any penalty to be reduced to reflect the level of disclosure. It also empowers HMRC to consider and apply special circumstances, which are to be set out in regulations made by HMRC.

165. Paragraph 30 of schedule 7A sets out how a penalty is to be assessed, paid and enforced.

166. Paragraph 31 of schedule 7A provides a right of appeal against a penalty.

167. Paragraph 32 of schedule 7A sets out the procedure for appeals against penalties.

168. Paragraph 33 of schedule 7A sets out the tax treatment of any payment made between companies in respect of penalties charged on the recipient of the payment. Such payments are to be ignored for tax purposes, up to the amount of the penalty.

Part 3: Duty to keep and preserve records

169. Paragraph 34 of schedule 7A requires a reporting company to keep and preserve certain records.

170. Paragraph 35 of schedule 7A sets out the penalty for failure to comply with the requirements of paragraph 34.

Part 4: Enquiry into interest restriction return

171. Paragraph 36 of schedule 7A provides a power for HMRC to open an enquiry into an interest restriction return. The provisions are similar to those in Part 4 of schedule 18 of FA 1998, adapted for the purposes of interest restriction returns. In particular, an enquiry into an interest restriction return does not affect, and is not affected by, any enquiry into a company tax return of a member of the group. Paragraph 36(6) permits a company tax return to be amended in consequence of an enquiry into an interest restriction return, irrespective of the status of any enquiry into the company's tax return.

172. Paragraph 37 of schedule 7A sets out the normal time limits within which an enquiry may be opened.

173. Paragraph 38 of schedule 7A sets out certain extended time limits within which an enquiry may be opened. These time limits apply if one or more conditions set out in paragraph 38(1) is met.

174. Paragraph 39 of schedule 7A sets out the scope of an enquiry into an interest restriction return. The enquiry cannot consider any matters contained in a company tax return that affect the interest restriction return. That is, the accuracy of any amounts of tax-interest or other components of tax-EBITDA of a company are matters for an enquiry into that company's tax return and not for an enquiry into the interest restriction return. But it is possible for HMRC to enquire into how such an amount should be treated for the purposes of Part 10.

175. Paragraph 40 of schedule 7A permits the scope of an enquiry to include the composition of the worldwide group and whether the period of account is correctly identified.

176. Paragraph 41 of schedule 7A allows HMRC to amend a company's self-assessment, during the course of an interest restriction enquiry, where it is considered that the tax payable is understated in the company's return. An appeal is possible.

177. Paragraph 42 of schedule 7A applies where a reporting company amends an interest restriction return during the course of an enquiry. The amendment may be taken into account in the enquiry but is not given effect until completion of the enquiry.

178. Paragraph 43 of schedule 7A sets out what steps HMRC must take on completion of an enquiry. A closure notice must be issued. Where relevant, that notice must state any change to the period of account (paragraph 43(3)) or the composition of the group (paragraph 43(4) to (6)).

179. Paragraph 44 of schedule 7A enables the reporting company to apply to the tribunal for a notice that HMRC must give a closure notice in relation to an enquiry.

180. Paragraph 45 of schedule 7A sets out the required contents of a closure notice. Paragraph 45(2)(b) covers all revisions that may be required to a return, including those that may arise as a result of paragraph 45(3): where the return was for the wrong period of account; or paragraph 45(5): where the composition of the group was incorrect. The notice need not specify how amounts are to be allocated.

181. Paragraph 45(6) covers the situation where the group composition was incorrect because some companies who were not members of the worldwide group had been included in the return.

182. Paragraph 45(7) covers the situation where one or more companies have been excluded incorrectly from the worldwide group, and the ultimate parent of the group is not the ultimate parent of a worldwide group for which a reporting company has been appointed. Paragraph 47 covers the situation where the ultimate parent is already the ultimate parent of another such group.

183. Paragraph 46 of schedule 7A requires the reporting company to amend the interest

restriction return to give effect to the conclusions in the enquiry closure notice, including any consequential effects. If the company does not do so, HMRC may take action under paragraph 52.

184. Paragraph 47 of schedule 7A applies where HMRC determines that the interest restriction return should have been submitted for a different group, where one or more entities was incorrectly excluded from the original group and where the ultimate parent is already the ultimate parent of another such group. HMRC must appoint a reporting company for the "new group", which must then undertake all the requirements regarding an interest restriction return. Any interest restriction return, notice of enquiry, and appeal in relation to the original group is treated as withdrawn.

185. Paragraph 48 of schedule 7A provides a right of appeal against the conclusion stated in a closure notice under paragraph 45, or against a notice given under paragraph 47.

186. Paragraph 49 of schedule 7A covers the situation where the worldwide group has a different composition to that for which the interest restriction return was originally submitted, and where the reporting company that submitted the original return is not a member of the revised group. HMRC may appoint a new reporting company. This may apply, for instance, if HMRC concludes that some of the members of a group for which a return was submitted are members of one or more different groups.

187. Paragraph 50 of schedule 7A ensures full continuity of application of the provisions of schedule 7A where there is more than one reporting company for a period of account.

Part 5: Determinations by officers of Revenue and Customs

188. Paragraph 51 of schedule 7A provides HMRC with the power to make a determination where a reporting company has failed to make a compliant interest restriction return by the filing deadline and HMRC considers that a disallowance should be made. The disallowance is shared between UK group companies on a pro rata basis. In each case HMRC must inform the company of its disallowance and notify the reporting company.

189. Paragraph 52 of schedule 7A provides HMRC with a power to determine the pro-rata shares of the disallowed amounts where the reporting company fails to make the amendments required under paragraph 45. The company tax return of any relevant group company is amended accordingly. HMRC must take action under this paragraph within 3 months of the end of the period for revision of the interest restriction return by the reporting company.

190. Paragraph 53 of schedule 7A extends the time limits for submission of a return, if necessary, where this is the result of an HMRC determination.

Part 6: Information powers exercisable by members of group

191. Paragraph 54 of schedule 7A sets out what information must be provided by

members of the group to the reporting company. It also requires the reporting company to send a copy of the interest restriction allocation to all relevant companies. A "relevant company" is a company that was a UK group company (defined in section 457) at any time in the group's period of account. In all cases the requirement is enforceable between the parties involved.

192. Paragraph 55 of schedule 7A sets out what information may be required by a group company from other group companies, where a reporting company has not been appointed. Again, the requirement is enforceable between the parties involved.

Part 7: Information powers exercisable by officers of Revenue and Customs

193. Part 7 of the schedule deals with information powers similar to those in Schedule 35 to FA 2008 but designed to be applied in connection with an enquiry into an interest restriction return.

194. Paragraph 56 of schedule 7A provides that HMRC may serve a notice on a member of a group requiring it to provide information or documents reasonably required for checking an interest restriction return.

195. Paragraph 57 of schedule 7A provides for a third party information notice to be served in connection with checking an interest restriction return. A third party is defined as a party that is not a member of the group. The service of such a notice requires either the consent of a UK group company or the approval of the tribunal.

196. Paragraph 58 of schedule 7A provides that where a group has submitted an interest restriction return, a notice can only be served if that return is under enquiry.

197. Paragraph 59 of schedule 7A provides a right of appeal against a notice under paragraph 56; and a right of appeal against a notice under paragraph 57, but only where the tribunal has not approved the giving of the notice.

198. Paragraph 60 of schedule 7A applies certain provisions of Schedule 36 to FA 2008 to the information powers exercisable under paragraph 56 or 57.

199. Paragraph 61 of schedule 7A explains what is meant by "checking an interest restriction return".

Part 8: Company tax returns

200. Paragraph 62 of schedule 7A provides that certain elections affecting the amounts in a company's tax return must be made in those returns.

201. Paragraph 63 of schedule 7A makes further provision for company to amend their returns following an election under section 375, 377 and 380, or as required under section 376.

202. Paragraph 64 of schedule 7A provides that a company's tax return is treated as amended to take account of any changes to its profits or losses that arise from an

interest restriction return. In particular, this will apply where the interest restriction return changes the amounts of disallowance or reactivation that are allocated to a particular company.

203. Paragraph 65 of schedule 7A provides a regulation-making power in relation to amendments of a company tax return made in accordance with paragraph 64, or any other amendments of a company tax return in connection with the rules introduced by this schedule.

204. Paragraph 66 of schedule 7A permits a company to make, amend or revoke certain claims following amendments to its company tax returns that are consequent on an interest restriction return.

205. Paragraph 67 of schedule 7A specifies that "company tax return" means a return under schedule 18 to FA 1998.

Part 9: Supplementary

206. Paragraph 68 of schedule 7A ensures that a person cannot be liable to a penalty under this schedule in addition to being convicted of an offence.

207. Paragraph 69 of schedule 7A confirms that a notice of appeal must specify the grounds of the appeal.

208. Paragraph 70 of schedule 7A confirms that amounts in an interest restriction return are conclusively determined where they have been subject to an enquiry that has been concluded.

Part 3 of schedule 1: Consequential amendments

209. Paragraph 3 amends section 98 of TMA 1970

210. Paragraph 4 amends paragraph 88 of schedule 18 to FA 1998.

211. Paragraph 5 amends section A1 of CTA 2009.

212. Paragraphs 6 to 8 amend CTA 2010.

213. Paragraphs 9 to 16 make consequential amendments to TIOPA 2010.

214. Paragraph 17 repeals Part 7 of TIOPA 2010 (Tax Treatment of Financing Costs and Income, commonly referred to as the "Debt Cap"), which is superseded by the corporate interest restriction rules. The main rule is that the current Debt Cap legislation will cease to have effect for periods of account commencing on or after 1 April 2017. Certain related provisions are also repealed.

215. Paragraph 18 amends Chapter 3 of Part 9A of TIOPA. This amends Section 371CE and inserts a New Section 371CEA which defines a group treasury company for the purposes of determining the charge gateway in the Controlled Foreign Company (CFC) rules. This provision replaces the definition from the repealed Debt Cap rules.

216. Paragraph 19 amends Chapter 9 of Part 9A of TIOPA. This replaces Section 371IE, the existing rule that provides relief under the CFC rules for 'matched interest', with an equivalent provision following the repeal of the current Debt Cap rules.

217. Paragraph 20 amends Chapter 19 of Part 9A of TIOPA. This includes a New Section 371SLA which sets out certain assumptions to be made in applying the corporate interest restriction rules in the calculation of chargeable profits of a CFC.

218. Paragraph 21 deals with the consequences of inserting a new Part 10 into TIOPA 2010. The existing Part 10 becomes Part 11, the existing sections 375 and 376 are repealed (subject to a saving provision), and the existing sections 372 to 374 and 377 to 382 are renumbered as sections 478 to 486.

219. Paragraph 22 introduces a new index of defined expressions as Part 7 of schedule 11 to TIOPA 2010.

Part 4 of schedule 1: Commencement and transitional provision

220. Paragraph 22 sets out the commencement rules, the main commencement provision being that the rules will have effect for periods of account commencing on or after 1 April 2017. Where the group draws up accounts (or is so treated as doing so) which straddle 1 April 2017, the rules apply as if accounts were drawn up for two separate periods, one ending 31 March 2017 and another starting on 1 April 2017.

221. Where it is just and reasonable to do so, groups may take accounts that have been prepared and apportion amounts to the respective notional periods; but if such an approach is not just or reasonable, the rules should have effect on the assumption that accounts had been prepared for the respective notional periods.

222. Paragraph 23 makes transitional provision by excluding amounts that are being brought into account under the Change of Accounting Practice Regulations 2004 (S.I. 2004/3271) from the rules where the change of accounting policy occurred in a period that commenced before 1 April 2017. In particular, such amounts will be left out of account of both tax-interest and tax-EBITDA amounts.

223. Paragraph 24 makes transitional provision by excluding amounts that are being brought into account under the transitional rules as a result of the changes made to the loan relationship and derivative contract rules (Parts 5 and 7 of the Corporation Tax Act 2009) made by Finance (No.2) Act 2015. In particular, such amounts will be left out of account of both tax-interest and tax-EBITDA amounts.

224. Paragraph 25 provides groups with an option to apply the corporate interest restriction rules on the assumption that companies had elected into regulations 7, 8 and 9 of the Disregards Regulations (S.I. 2004/3256). This therefore disregards the fair value movements on certain hedging derivative contracts from being included in the tax-interest and tax-EBITDA figures. Instead brings these amount into account in line

with hedged item. For this to have effect, all UK group companies as at 1 April 2017 must elect into this treatment. The election applies to all derivative contracts entered into before 1 April 2020.

225. Paragraph 26 provides group with an extended time limit through to 31 December 2017 to make an election under section 427 to be treated as a qualifying company under the Public Infrastructure rules.

226. Paragraph 27 provides that the Commissioners may make consequential amendments to secondary legislation which have effect under the same commencement rules.

Background note

227. This legislation has its origins in the G20/OECD project to tackle Base Erosion and Profit Shifting (BEPS) in relation to the taxation of international groups of companies. The BEPS project identified a number of key risks to be tackled. It was noted that BEPS risks in the area of interest payments may arise in three basic scenarios:

- Groups placing higher levels of third party debt in high tax countries.
- Groups using intragroup loans to generate interest deductions in excess of the group's actual third party interest expense.
- Groups using third party or intragroup financing to fund the generation of tax exempt income.

228. To address these risks, Action 4 of the OECD's Action Plan on Base Erosion and Profit Shifting, published in 2013, called for recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense. Following several rounds of discussions and public consultation, the OECD published recommendations on preventing base erosion through the use of interest expense in October 2015. Following further work, the OECD published additional guidance in December 2016 on the design and operation of the group ratio rule, and approaches to deal with risks posed by the banking and insurance sectors.

229. The recommended approach is based on a fixed ratio rule which limits an entity's net deductions for interest and payments economically equivalent to interest to a percentage of its taxable earnings before interest, taxes, depreciation and amortisation (EBITDA).

230. Recognising that some groups are highly leveraged with third party debt for non-tax reasons, the recommended approach proposes a group ratio rule alongside the fixed ratio rule. This would allow an entity with net interest expense above a country's fixed ratio to deduct interest up to the level of the net interest to EBITDA ratio of its worldwide group.

231. The recommended approach also allows countries to supplement the fixed ratio rule and group ratio rule with other provisions that reduce the impact of the rules on entities or situations which pose a lower BEPS risk, such as:

- A *de minimis* threshold which carves-out entities which have a low level of net interest expense. Where a group has more than one entity in a country, it is recommended that the threshold be applied to the total net interest expense of the local group.
- An exclusion for interest paid to third party lenders on loans used to fund public-benefit infrastructure, subject to conditions. In these circumstances, an entity may be highly leveraged but, due to the nature of the assets and the close link to the public sector, the BEPS risk is reduced.
- The carry forward of disallowed interest expense and/or unused interest capacity (where an entity's actual net interest deductions are below the maximum permitted) for use in future years. This will reduce the impact of earnings volatility on the ability of an entity to deduct interest expense. The carry forward of disallowed interest expense will also help entities which incur interest expenses on long-term investments that are expected to generate taxable income only in later years, and will allow entities with losses to claim interest deductions when they return to profit.

232. This legislation looks to implement the OECD's recommendations as follows.

233. The rules will operate on a worldwide group basis for each period of account of the group's ultimate parent. This will allow groups to manage any restriction across their businesses. The rules will apply to the net interest expense within the charge to Corporation Tax, including other similar financing costs. Groups with less than £2 million of net interest expense within the scope of Corporation Tax per annum will not need to apply the rules. All groups will continue to be able to deduct current period net interest expenses and similar financing costs up to that amount.

234. The Fixed Ratio Rule will limit the amount of net interest expense that a worldwide group can deduct against its taxable profits to 30% of its taxable "EBITDA" – earnings before interest, taxes, depreciation and amortisation. A modified debt cap within the new rules will ensure the net interest deduction does not exceed the total net interest expense of the worldwide group.

235. The Group Ratio Rule allows a 'group ratio' to be substituted for the 30% figure. The group ratio is based on the net interest expense to EBITDA ratio for the worldwide group based on its consolidated accounts. Interest payable to shareholders and other related parties, and interest on instruments with equity-like features are not reflected

in the group ratio.

236. Groups may make an irrevocable 'alternative calculation' election to make certain prescribed adjustments to the accounting figures to more closely align them with how amounts of 'interest' and 'EBITDA' would be calculated under UK tax rules. This election has effect for both the operation of the modified debt cap rule and the Group Ratio Rule.

237. The Public Infrastructure rules provide rules which exclude from the scope of the main rules amounts of qualifying interest expense incurred by qualifying companies on funds invested in long-term infrastructure for the public benefit. These rules will not exclude interest payable to shareholders and other related parties (except in the case of some existing loans or where the other party is itself a qualifying company), nor where the lender has recourse to income or assets other than those connected with public benefit infrastructure that is fully within the scope of UK taxation.

238. There are rules to help address timing differences between interest expense and EBITDA. Amounts of restricted interest are carried forward indefinitely. They are deducted in a later period to the extent there is sufficient interest allowance. Unused interest allowance can be carried forward for up to five years.

239. There are special rules to deal with particular issues, for example: derivatives, the Patent Box and other tax incentives, Double Taxation Relief, joint ventures, the Oil and Gas tax regime, Real Estate Investment Trusts (REITs), investments held by insurance companies, fair value accounting, co-operative and community benefit societies, payments to charities and leases. More details are included in the government's response to the consultation that was published on 5 December.

240. There is a regime-wide anti-avoidance rule.

241. The core mechanics of the rules were reflected in an earlier draft of this legislation published on 5 December 2016. Some further aspects of the rules are included for the first time in the draft published alongside this note. A list of aspects that were included in the earlier draft, and a list of those which are included for the first time in this draft, were included in chapter 7 of the government response to the consultation that was also published on 5 December.

242. For the most part, this draft legislation is intended to give effect to the policy set out in the government response to the consultation. However, following receipt of comments on the policy and the December draft of the legislation, the government has made certain detailed policy changes which are reflected in the latest draft. These changes include the following.

- The Public Infrastructure rules (referred to in the consultation response document as the "Public Benefit Infrastructure Exemption") will now require a prospective election, but this election will be revocable once it has been in effect for a minimum of five years. Once it has been revoked another election cannot take effect for the same company within a further five years.

- If a company does not comply in any accounting period with all the conditions of the Public Infrastructure rules, and this non-compliance has not been contrived with a main purpose of obtaining a tax advantage, the Public Infrastructure rules will not apply to that company in that period. This means that any interest income and EBITDA of the company will not be excluded when calculating how much interest the group can deduct under the main rules.
- The list of tax reliefs to be disregarded in calculating tax-EBITDA is extended to include certain reliefs for the creative industries: film tax relief, television tax relief, video games tax relief, relief in relation to theatrical productions, orchestra tax relief, and museums and galleries exhibition tax relief.
- There will be no rules specifying how much of the restriction is to be allocated to interest expense to which the Northern Ireland rate of Corporation Tax applies.
- The regime-wide anti-avoidance rule will not apply to certain ‘commercial restructuring arrangements’. This covers cases where loan receivables held offshore are transferred to be within the charge to Corporation Tax. It also covers straight forward restructuring to benefit from the legitimate use of reliefs within the interest restriction rules.

243. In addition, the following change has been made to the intended effect of the draft legislation published on 5 December to better reflect the policy set out in the government response to the consultation.

- If a group has aggregate net tax-interest income for a period it is added to the interest allowance for that period. This means that carried forward interest amounts will be able to be deducted in subsequent periods to the extent they can be set off against net tax-interest income in those periods.

244. In consequence of the introduction of the corporate interest restriction rules, the following changes will be made by way of amendment to secondary legislation. Draft regulations will be published for comment.

- ‘Interest distributions’ under regulations 18, 69Z16 and 69Z61 of the Authorised Investment Funds (Tax) Regulations (S.I. 2006/964) will not be amounts of tax-interest expense.

- ‘Interest distributions’ under regulations 5 of the Investment Trusts (Dividends) (Optional Treatment as Interest Distributions) Regulations (S.I. 2009/2034) will not be amounts of tax-interest expense.
- The retained profit of a company within the Taxation of Securitisation Companies Regulations (S.I. 2006/3296) will be treated as an amount of tax-interest income.
- The exclusion of expense amounts from results-dependent securities from qualifying net group-interest expense under section 410(3)(b) will not apply to instruments issued by a company within the Taxation of Securitisation Companies Regulations (S.I. 2006/3296).

245. If you have any questions about or comments on this measure, please contact the Corporate Interest Restriction team on email: interest-restriction.mailbox@hmrc.gsi.gov.uk or telephone: 03000 569068.