

1 Avoidance involving profit fragmentation arrangements

Schedule 1 contains provision about profit fragmentation arrangements.

SCHEDULE 1

Section 1

AVOIDANCE INVOLVING PROFIT FRAGMENTATION ARRANGEMENTS

Introduction and overview

- 1 (1) This Schedule contains provision about countering the tax effects of certain arrangements (“profit fragmentation arrangements”).
- (2) Profit fragmentation arrangements involve the following parties –
 - (a) a person resident in the United Kingdom (“the resident party”),
 - (b) an overseas person or entity (“the overseas party”), and
 - (c) an individual resident in the United Kingdom (a “related individual”) who is –
 - (i) the resident party,
 - (ii) a member of a partnership of which the resident party is a partner, or
 - (iii) a participator in a company which is the resident party.
- (3) An “overseas person or entity” means –
 - (a) a person abroad within the meaning given by section 718 of ITA 2007, or
 - (b) a company, partnership, trust or other entity or arrangements established or having effect under the law of a country or territory outside the United Kingdom (regardless of whether it has legal personality as a body corporate).
- (4) Paragraphs 2 to 6 deal with the definition of profit fragmentation arrangements.
- (5) Paragraph 7 deals with the counteraction of the effects of such arrangements.
- (6) Other provisions of this Schedule –
 - (a) deal with double taxation and the tax treatment of reimbursement payments (paragraphs 8 and 9),
 - (b) ensure that an officer of Revenue and Customs is notified of arrangements that are potentially profit fragmentation arrangements (paragraph 10), and
 - (c) deal with interpretation and commencement (paragraphs 11 to 13).

Profit fragmentation arrangements

- 2 (1) Arrangements are “profit fragmentation arrangements” if –
 - (a) provision has been made or imposed as between the resident party and the overseas party by means of the arrangements (“the material provision”),
 - (b) as a result of the material provision, value is transferred as between those parties which derives directly or indirectly from anything done for the purposes of or in connection with a business whose profits are chargeable to income tax or corporation tax (see paragraph 3),
 - (c) the value transferred is greater than the value which the overseas party would receive in consideration for any services provided by

that party if the value were being transferred between parties acting at arm's length,

- (d) the material provision results in a tax mismatch for a tax period of the resident party (see paragraphs 4 and 5), and
 - (e) any of the enjoyment conditions are met in relation to a related individual (see paragraph 6).
- (2) For the purposes of sub-paragraph (1)(a) provision made or imposed as between a partnership of which the resident party is a member and the overseas party is to be regarded as provision made or imposed as between the resident party and the overseas party.

Transfer of value deriving directly or indirectly from income

- 3 (1) In determining whether value deriving directly or indirectly from the income of a business is transferred between the resident party and the overseas party, account is to be taken of any method, however indirect, by which—
- (a) any property or right is transferred or transmitted, or
 - (b) the value of any property or right is enhanced or diminished.
- (2) Sub-paragraph (1) applies in particular to—
- (a) sales, contracts and other transactions made otherwise than for full consideration or for more than full consideration,
 - (b) any method by which any property or right, or the control of any property or right, is transferred or transmitted by assigning—
 - (i) share capital or other rights in a company,
 - (ii) rights in a partnership, or
 - (iii) an interest in settled property,
 - (c) the creation of an option affecting the disposition of any property or right and the giving of consideration for granting it,
 - (d) the creation of a requirement for consent affecting such a disposition and the giving of consideration for granting it,
 - (e) the creation of an embargo affecting such a disposition and the giving of consideration for releasing it, and
 - (f) the disposal of any property or right on the winding up, dissolution or termination of a company, partnership or trust.
- (3) Value may be traced through any number of companies, partnerships, trusts and other entities or arrangements.
- (4) The property held by a company, partnership, trust or other entity or under any arrangements must be attributed to the shareholders, partners, beneficiaries or other participants at each stage in whatever way is appropriate in the circumstances.

Tax mismatch

- 4 (1) The material provision results in a tax mismatch for a tax period of the resident party if—
- (a) in that period, in relation to a relevant tax, it results in one or both of—

-
- (i) expenses of the resident party for which a deduction has been taken into account in computing the amount of the relevant tax payable by the resident party, or
 - (ii) a reduction in the income of the resident party which would otherwise have been taken into account in computing the amount of the relevant tax payable by the resident party,
 - (b) the resulting reduction in the amount of the relevant tax which is payable by the resident party exceeds the resulting increase in relevant taxes payable by the overseas party for the period corresponding to the tax period,
 - (c) the results described in paragraphs (a) and (b) are not exempted by sub-paragraph (4), and
 - (d) the overseas party does not meet the 80% payment test.
- (2) In this Schedule, references to “the tax reduction” are to the amount of the excess mentioned in sub-paragraph (1)(b).
- (3) It does not matter whether the tax reduction results from the application of different rates of tax, the operation of a relief, the exclusion of any amount from a charge to tax, or otherwise.
- (4) The results described in sub-paragraph (1)(a) and (b) are exempted if they arise solely by reason of –
- (a) contributions paid by an employer under a registered pension scheme, or overseas pension scheme, in respect of any individual,
 - (b) a payment to a charity,
 - (c) a payment to a person who, on the ground of sovereign immunity, cannot be liable for any relevant tax, or
 - (d) a payment to an offshore fund or authorised investment fund –
 - (i) which meets the genuine diversity of ownership condition (whether or not a clearance has been given to that effect), or
 - (ii) at least 75% of the investors in which are, throughout the accounting period, registered pension schemes, overseas pension schemes, charities or persons who cannot be liable for any relevant tax on the ground of sovereign immunity.
- (5) “The 80% payment test” is met by the overseas party if the resulting increase in relevant taxes paid by that party as mentioned in sub-paragraph (1)(b) is at least 80% of the amount of the resulting reduction in the amount of the relevant tax payable by the resident party.
- (6) In this paragraph and paragraph 5, where the overseas party does not have an actual period for the purposes of relevant taxes which coincides with the tax period of the resident party –
- (a) references to the corresponding period of the overseas party in relation to that tax period are to a notional period of that party for the purposes of relevant taxes that would coincide with that tax period, and
 - (b) such apportionments as are just and reasonable are to be made to determine the income or tax liability of that party for that corresponding period.
- (7) In this paragraph –
- “relevant tax” means –
- (a) income tax,

- (b) corporation tax on income,
 - (c) a sum chargeable under section 269DA of CTA 2010 (surcharge on banking companies) as if it were an amount of corporation tax,
 - (d) a sum chargeable under section 330(1) of CTA 2010 (supplementary charge in respect of ring fence trades as if it were an amount of corporation tax), or
 - (e) any non-UK tax on income, and
- “tax period”, in relation to a resident party, means –
- (a) a tax year, or
 - (b) if the resident party is a company, an accounting period of that party.

Tax mismatch: resulting reduction and resulting increase

- 5 (1) For the purposes of paragraph 4, the resulting reduction in the resident party’s liability to a relevant tax for a tax period is –

$$A \times TR$$

where –

A is the sum of –

- (a) if there are expenses within paragraph 4(1)(a)(i), the lower of the amount of expenses and the amount of the deduction mentioned in that provision, and
- (b) any reduction in income mentioned in paragraph 4(1)(a)(ii), and

TR is the rate at which, assuming the resident party has profits equal to A chargeable to the relevant tax for the tax period, those profits would be chargeable to that tax.

For this purpose, the rate at which those profits would be chargeable to that tax for that period is the highest rate at which that tax would be chargeable for that period if those profits were added to the resident party’s total income.

- (2) For the purposes of paragraph 4(1)(b) and (4), the resulting increase in relevant taxes payable by the overseas party for the period corresponding to the tax period is any increase in the total amount of relevant taxes that would fall to be paid by that party (and not refunded) assuming that –
- (a) the overseas party’s income for that period, in consequence of the material provision were an amount equal to A,
 - (b) account were taken of any deduction or relief (other than any qualifying deduction or qualifying loss relief) taken into account by the overseas party in determining that party’s actual liability to any relevant taxes in consequence of the material provision, and
 - (c) all further reasonable steps were taken –
 - (i) under the law of any part of the United Kingdom or any country or territory outside the United Kingdom, and
 - (ii) under double taxation arrangements made in relation to any country or territory,
 to minimise the amount of tax which would fall to be paid by the overseas party in the country or territory in question (other than steps to secure the benefit of any qualifying deduction or qualifying loss relief).

-
- (3) The steps mentioned in sub-paragraph (2)(c) include –
- (a) claiming, or otherwise securing the benefit of, reliefs, deductions, reductions or allowances, and
 - (b) making elections for tax purposes.
- (4) For the purposes of this paragraph, any withholding tax which falls to be paid on payments made to the overseas party is (unless it is refunded) to be treated as tax which falls to be paid by that party (and not the person making the payment).
- (5) For the purposes of this paragraph, an amount of tax payable by the overseas party is refunded if and to the extent that –
- (a) any repayment of tax, or any payment in respect of a credit for tax, is made to any person, and
 - (b) that repayment or payment is directly or indirectly in respect of the whole or part of the amount of tax payable by the overseas party,
- but an amount refunded is to be ignored if and to the extent that it results from qualifying loss relief obtained by that party.
- (6) Where the overseas party is a member of a partnership, in paragraph 4 and this paragraph –
- (a) references to that party’s liability to any tax (however expressed) include a reference to the liabilities of all members of the partnership to the tax,
 - (b) references to any tax being payable by that party (however expressed) include a reference to tax being payable by any member of the partnership, and
 - (c) references to loss relief obtained by that party include a reference to loss relief obtained by any member of the partnership,
- and sub-paragraph (4) applies to any member of the partnership as it applies to that party.
- (7) In this paragraph –
- “qualifying deduction” means a deduction which –
 - (a) is made in respect of actual expenditure of the overseas party,
 - (b) does not arise directly from the arrangements,
 - (c) is of a kind for which the resident party would have obtained a deduction in calculating that party’s liability to any income tax or corporation tax had that party incurred the expenditure in respect of which the deduction is given, and
 - (d) does not exceed the amount of the deduction that the resident party would have so obtained,
 - “qualifying loss relief” means any means by which a loss might be used for tax purposes to reduce the amount in respect of which the overseas party is liable to tax on the profits of a business, and
 - “relevant tax” has the same meaning as in paragraph 4.

The enjoyment conditions

- 6 (1) The enjoyment conditions are met in relation to a related individual if –
- (a) it is reasonable to suppose that some or all of the value transferred as a result of the material provision relates to something done by, or any property or purported right of, the individual, and

- (b) under the arrangements –
 - (i) the individual (whether acting alone or with any other person) procures the transfer of the value,
 - (ii) the value transferred, or part of it, is so dealt with by any person as to be calculated at some time to enure for the benefit of the individual,
 - (iii) the value transferred, or part of it, operates to increase the value of any assets which the individual holds or are held for the benefit of the individual,
 - (iv) the individual receives or is entitled to receive any benefit provided or to be provided out of the value transferred or part of it,
 - (v) the individual may become entitled to the beneficial enjoyment of the value transferred, or part of it, if one or more powers are exercised or successively exercised (and for those purposes it does not matter who may exercise the powers or whether they are exercisable with or without the consent of another person), or
 - (vi) the individual (whether acting alone or together with any other person) is able in any manner to control directly or indirectly the application of the value transferred or part of it.
- (2) In determining whether the enjoyment conditions are met in relation to an individual and the value transferred as a result of the material provision, all benefits which may at any time accrue to a person as a result of the value being transferred must be taken into account, irrespective of –
 - (a) the nature or form of the benefits, or
 - (b) whether the person has legal or equitable rights in respect of the benefits.
- (3) For the purposes of sub-paragraphs (1)(b) and (2), references to an individual include a reference to any person connected with that individual and, for the purposes of this paragraph, section 993 of ITA 2007 (meaning of “connected”) has effect but as if –
 - (a) subsection (4) of that section were omitted, and
 - (b) partners in a partnership in which the an individual is also a partner were not “associates” of the individual for the purposes of sections 450 and 451 of CTA 2010 (“control”).
- (4) For the purposes of sub-paragraph (3), an individual is treated as connected with a person or entity if –
 - (a) the individual or a person connected with the individual (whether acting alone or with any other person) –
 - (i) is able to secure that the person or entity acts in accordance with the wishes of the individual or any person connected with the individual,
 - (ii) is able to acquire rights which would enable the individual or any person connected with the individual to secure that the person or entity acts in accordance with the wishes of the individual or any person connected with the individual, or
 - (iii) is able to exercise significant influence over the person or entity (whether or not as a result of a legal entitlement of the individual or any person connected with the individual), or

-
- (b) the person or entity can reasonably be expected to act, or typically acts, in accordance with the wishes of the individual or a person connected with the individual.

Counteracting effects of arrangements

- 7 (1) If it is reasonable to conclude that profit fragmentation arrangements were entered into to obtain a tax advantage, the tax advantages that would (ignoring this Schedule) arise from the arrangements must be counteracted by the making of such adjustments as are just and reasonable.
- (2) Any adjustments required to be made by this paragraph (whether or not by an officer of Revenue and Customs) may be made by way of—
 - (a) an assessment,
 - (b) the modification of an assessment, or
 - (c) amendment or disallowance of a claim,or otherwise.

Double taxation

- 8 (1) This paragraph applies where—
 - (a) tax is charged on the resident party by virtue of the application of paragraph 7, and
 - (b) at any time, a tax (whether income tax, corporation tax or another United Kingdom tax) is charged on the resident party or another person otherwise than by virtue of the application of paragraph 7 which results in a double charge to tax.
- (2) In order to avoid the double charge to tax, the resident party may make a claim in writing for one or more consequential adjustments to be made in respect of the tax charged mentioned in sub-paragraph (1)(a).
- (3) On a claim under this paragraph an officer of Revenue and Customs must make such of the consequential adjustments claimed (if any) as are just and reasonable.
- (4) The amount of any consequential adjustments must not exceed the lesser of—
 - (a) the tax charged on the resident party as mentioned in sub-paragraph (1)(a), and
 - (b) the tax charged as mentioned in sub-paragraph (1)(b).
- (5) Consequential adjustments may be made—
 - (a) in respect of any tax period,
 - (b) by way of an assessment, the modification of an assessment, the amendment of a claim or otherwise, and
 - (c) despite any time limit imposed by or under any enactment.

Reimbursement payments ignored for tax purposes

- 9 In calculating income, profits or losses for any tax purposes, no account is to be taken of any amount which is paid (directly or indirectly) by a person for the purposes of meeting or reimbursing the cost of tax charged on the resident party by virtue of the application of paragraph 7.

Notification of arrangements

- 10 (1) Where arrangements meet the requirements in paragraph 2(1)(a), (b), (d) and (e), the resident party must notify an officer of Revenue and Customs to that effect in relation to the tax period in which the material provision results in a tax mismatch (see paragraph 2(1)(d)).
- (2) A notification under sub-paragraph (1) must contain details of the arrangements including –
- (a) a description of the material provision in question and the parties between whom it has been made or imposed,
 - (b) the value transferred as a result of the material provision, and
 - (c) the amount of the tax reduction.
- (3) A notification under sub-paragraph (1) must be made in a tax return under TMA 1970 or paragraph 3 of Schedule 18 to FA 1998 (company tax return) for the tax period.
- (4) The duty under sub-paragraph (1) does not apply in relation to arrangements if it is reasonable to conclude that any of the following provisions apply in relation to the value transferred as a result of the material provision –
- (a) Part 4 of TIOPA 2010 (transfer pricing),
 - (b) Part 9A of that Act (controlled foreign companies), or
 - (c) Part 3 of FA 2015 (diverted profits tax).
- (5) The Commissioners for Her Majesty’s Revenue and Customs may direct that the duty under sub-paragraph (1) does not apply in relation to a tax period in other circumstances specified in the direction.

Treatment of a person who is a member of a partnership

- 11 (1) This paragraph applies where a person is a member of a partnership.
- (2) Any references in this Schedule to the expenses, income or profits of, or to the adjustment of the income or profits of, the person includes a reference to the person’s share of the income or profits of, or adjustment of the income or profits of, the partnership.
- (3) For this purpose “the person’s share” of an amount is determined by apportioning the amount between the partners on a just and reasonable basis.

Other defined terms

- 12 In this Schedule –
- “arrangements” includes any scheme, agreement, understanding, transaction or series of transactions (whether or not legally enforceable),
 - “authorised investment fund” means –
 - (a) an open-ended investment company within the meaning of section 613 of CTA 2010, or
 - (b) an authorised unit trust within the meaning of section 616 of that Act,
 - “business” includes any trade, profession or vocation,

“employer” has the same meaning as in Part 4 of FA 2004 (see section 279(1) of that Act),

“genuine diversity of ownership condition” means –

- (a) in the case of an offshore fund, the genuine diversity of ownership condition in regulation 75 of the Offshore Funds (Tax) Regulations 2009 (S.I. 2009/3001), and
- (b) in the case of an authorised investment fund, the genuine diversity of ownership condition in regulation 9A of the Authorised Investment Fund (Tax) Regulations 2006 (S.I. 2006/964),

“material provision” has the same meaning as in paragraph 2,

“offshore fund” has the same meaning as in section 354 of TIOPA 2010 (see section 355 of that Act),

“the overseas party” has the meaning given by paragraph 1(2),

“overseas pension scheme” has the same meaning as in Part 4 of FA 2004 (see section 150(7) of that Act),

“partnership” includes an entity established under the law of a country or territory outside the United Kingdom of a similar character to a partnership, and “partners”, in relation to such arrangements, is to be construed accordingly,

“related individual” and “the resident party” have the meanings given by paragraph 1(2),

“tax advantage” includes –

- (a) relief or increased relief from income tax or corporation tax,
- (b) repayment or increased repayment of income tax or corporation tax,
- (c) avoidance or reduction of a charge or an assessment to income tax or corporation tax,
- (d) avoidance of a possible assessment to income tax or corporation tax,
- (e) deferral of a payment of tax or advancement of a repayment of tax, and
- (f) avoidance of an obligation to deduct or account for tax,

“tax period” has the meaning given by paragraph 4(7),

“the tax reduction” has the meaning given by paragraph 4(2), and

“trust” includes arrangements –

- (a) which have effect under the law of a country or territory outside the United Kingdom, and
 - (b) under which persons acting in a fiduciary capacity hold and administer property on behalf of other persons,
- and “beneficiaries”, in relation to such arrangements, is to be construed accordingly.

Commencement

13 This Schedule has effect –

- (a) for income tax purposes, in relation to any value transferred on or after 6 April 2019 as a result of a material provision, and
- (b) for corporation tax purposes, in relation to any value transferred on or after 1 April 2019 as a result of a material provision.