

SCHEDULES

SCHEDULE 12

CONTROLLED FOREIGN COMPANIES

PART 1

EXEMPTIONS FOR COMPANIES WITH LIMITED UK CONNECTION

- 1 (1) Section 748 of ICTA (cases where apportionment of chargeable profits and creditable tax under section 747(3) does not apply) is amended as follows.
 - (2) In subsection (1), in paragraph (b) for “that Schedule” substitute “Schedule 25”.
 - (3) After that paragraph insert—
 - “(ba) the company is exempt for that period by virtue of Part 2A of that Schedule (exemption for trading companies with limited UK connection); or
 - (bb) the company is exempt for that period by virtue of Part 2B of that Schedule (exemption for companies exploiting intellectual property with limited UK connection); or”.
- 2 After section 751AA of that Act insert—

“751AB Reduction in chargeable profits: failure to qualify for exemptions

- (1) This section applies if—
 - (a) an apportionment under section 747(3) would fall to be made as regards an accounting period (“the relevant accounting period”) of a controlled foreign company,
 - (b) but for a relevant failure, section 748(1)(ba) or (bb) would have prevented such an apportionment, and
 - (c) a company resident in the United Kingdom (“the UK resident company”) has a relevant interest in the controlled foreign company in that period.
- (2) “Relevant failure” means—
 - (a) in the case of section 748(1)(ba), one or both of the following—
 - (i) a failure to satisfy the requirement of paragraph 12E of Schedule 25 (requirement as to company’s UK connection) in circumstances where the requirement would be satisfied if the reference in sub-paragraph (3)(a) of that paragraph to 10% were a reference to 50%, and
 - (ii) a failure to satisfy the requirement of paragraph 12F of that Schedule (finance income and relevant IP income) in circumstances where the relevant IP income of the

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controlled foreign company for the accounting period does not exceed 5% of the company's gross income for that period, and

- (b) in the case of section 748(1)(bb), a failure to satisfy the requirement of paragraph 12M of that Schedule (finance income).
- (3) The UK resident company may make an application to the Commissioners for Her Majesty's Revenue and Customs for the chargeable profits of the controlled foreign company for the relevant accounting period ("the chargeable profits") to be reduced to an amount specified in the application ("the specified amount").

The specified amount may be nil.

- (4) If the Commissioners grant the application—
- (a) the chargeable profits are treated as reduced to the specified amount, and
- (b) the controlled foreign company's creditable tax (if any) for that period is treated as reduced by so much of that tax as, on a just and reasonable basis, relates to the reduction in the chargeable profits, for the purpose of applying section 747(3) to (5) for determining the sum (if any) chargeable on the UK resident company under section 747(4)(a) (but for no other purpose).
- (5) The Commissioners may grant the application only if—
- (a) they are satisfied that the specified amount is not less than the relevant amount, and
- (b) they have not previously granted an application made by the UK resident company in respect of the relevant accounting period under section 751A or 751AC.
- (6) "The relevant amount" means—
- (a) if the relevant failure is within subsection (2)(a), the sum of—
- (i) the excess finance and IP income (if any) for the relevant accounting period, and
- (ii) in a case where there is a failure specified in subsection (2)(a)(i), so much (if any) of the net chargeable profits for that period as are not excluded by subsection (8), and
- (b) if the relevant failure is within subsection (2)(b)—
- (i) the amount (if any) by which the controlled foreign company's finance income for the relevant accounting period exceeds 5% of its gross income for that period, or
- (ii) if that amount is a negligible amount, nil.
- (7) "The excess finance and IP income" for the relevant accounting period means—
- (a) the amount (if any) by which the total of the controlled foreign company's finance income and relevant IP income for that period exceeds 5% of its gross income for that period, or
- (b) if that amount is a negligible amount, nil.
- (8) Net chargeable profits are excluded by this subsection if, and to the extent that, they can reasonably be regarded—

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- (a) as representing the net economic value which—
 - (i) arises to the appropriate body of persons (taken as a whole),
and
 - (ii) is created directly by qualifying work, or
 - (b) as not being wholly or partly attributable, directly or indirectly, to transactions with persons within the charge to United Kingdom tax.
- (9) In subsection (8)(a) “qualifying work” means work which—
- (a) is done in the territory in which the controlled foreign company is resident, and
 - (b) is done in that territory by individuals working for the controlled foreign company there.
- (10) A transaction with a company which is within the charge to United Kingdom tax only because it carries on a trade in the United Kingdom through a permanent establishment there is within subsection (8)(b) only if the transaction is attributable to activities carried on through that establishment.
- (11) For the purposes of subsections (8) and (9)—
- (a) section 751A(5), (6) and (9) applies as it applies for the purposes of the equivalent provisions of section 751A, and
 - (b) paragraph 5(2) to (5) of Schedule 25 (residence of controlled foreign company) applies as it applies in relation to Part 2 of that Schedule.
- (12) In this section—
- “finance income” has the meaning given by paragraph 12F(3) of Schedule 25 (with references to C read as references to the controlled foreign company);
 - “relevant IP income” has the meaning given by paragraph 12F(4) of that Schedule;
 - “net chargeable profits” means chargeable profits excluding so much of those profits as is directly attributable to the finance income or relevant IP income of the controlled foreign company;
 - “UK-connected gross income” has the same meaning as in paragraph 12E of Schedule 25;
 - “United Kingdom tax” means corporation tax or income tax;
- and paragraph 12G of that Schedule (gross income) applies for the purposes of this section as it applies for the purposes of Part 2A of that Schedule (with references to C read as references to the controlled foreign company).”
- 3 In Schedule 25 to that Act (cases where section 747(3) does not apply), after Part 2 insert—

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“PART 2A

TRADING COMPANIES WITH LIMITED UK CONNECTION

12B Introductory

- (1) For the purposes of section 748(1)(ba), a controlled foreign company (“C”) is exempt for an accounting period if the requirements of this Part of this Schedule are satisfied.
- (2) The requirements are those imposed as to C’s—
 - (a) business establishment (see paragraph 12C),
 - (b) business activities (see paragraph 12D),
 - (c) UK connection (see paragraph 12E), and
 - (d) finance income and relevant IP income (see paragraph 12F).

12C Business establishment

- (1) The requirement of this paragraph is that throughout the accounting period C has a business establishment in the territory in which it is resident.
- (2) For the purposes of sub-paragraph (1)—
 - (a) paragraph 5(2) to (5) (special rules about residence of the company) applies as it applies for the purposes of Part 2 of this Schedule, and
 - (b) paragraph 7 (meaning of “business establishment”) applies as it applies for the purposes of paragraph 6(1)(a).

12D Business activities

- (1) The requirement of this paragraph is that—
 - (a) C’s business does not, at any time during the accounting period, include to a substantial extent non-exempt activities, or
 - (b) if C is wholly engaged in business falling within paragraph 11(1)(c) (banking etc), C’s business does not, at any time during the accounting period, include to a substantial extent non-exempt activities which do not constitute investment business.
- (2) For this purpose—

“non-exempt activities” means—

 - (a) the holding or managing of shares or securities,
 - (b) the holding of intellectual property,
 - (c) dealing in securities, other than in the capacity of a broker,
 - (d) the leasing of any description of property or rights,
 - (e) the investment in any manner of funds which would otherwise be available, directly or indirectly, for investment by or on behalf of any person (whether resident in the United Kingdom or not) who has, or is connected or associated with a person who has, control, either alone or together with other persons, of C, and

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- (f) if C is not a member of an insurance group throughout the accounting period, the effecting or carrying out of contracts of insurance between C and persons related to C;
“investment business” means activities within paragraphs (a) to (d) of paragraph 9(1).
- (3) For the purposes of sub-paragraph (2)(f), a person is “related” to C if—
- (a) the person is connected or associated with C,
 - (b) the person has a 25 per cent assessable interest in C in the case of the accounting period in question (within the meaning of paragraph 6(4C)), or
 - (c) if C is a controlled foreign company in that accounting period by virtue of subsection (1A) of section 747, the person is connected or associated with either or both of the two persons mentioned in that subsection.
- (4) In sub-paragraph (2)—
- “broker” includes any person offering to sell securities to, or purchase securities from, members of the public generally;
 - “contract of insurance” has the meaning given by Article 3(1) of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001;
 - “insurance group” has the meaning given by paragraph 11A(4);
 - “intellectual property” is to be construed in accordance with paragraph 9(1A);
 - “member of an insurance group” has the meaning given by paragraph 11A(6).

12E UK connection

- (1) The requirement of this paragraph is that C does not have a significant connection with the United Kingdom during the accounting period.
- (2) C has a significant connection with the United Kingdom during the accounting period if Condition A or B is met.
- (3) Condition A is that—
- (a) the UK-connected gross income of C’s business for that period exceeds 10% of the gross income of that business for that period, and
 - (b) sub-paragraph (4) does not apply.
- (4) This sub-paragraph applies if—
- (a) at all times in the accounting period there are sufficient individuals working for C in the territory in which it is resident, or in any other territory outside of the United Kingdom, who have the competence and authority to undertake all, or substantially all, of C’s business,
 - (b) C’s relevant profits for the accounting period do not exceed 10% of C’s relevant operating expenses for that period, and
 - (c) the UK-connected gross income of C’s business for that period does not exceed 50% of the gross income of that business for that period.
- (5) Condition B is that—

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- (a) the UK-connected related-party business expenditure of C's business for that period exceeds 50% of the total related-party business expenditure of C's business for that period, and
 - (b) during the accounting period C has been involved in a scheme where the main purpose, or one of the main purposes, of any party to the scheme in entering into the scheme is to achieve a reduction in corporation tax or any tax chargeable as if it were corporation tax.
- (6) For the purposes of sub-paragraph (4)(a), individuals are not to be regarded as working for C in any territory unless—
- (a) they are employed by C in the territory, or
 - (b) they are otherwise directed by C to perform duties on its behalf in the territory.
- (7) In this paragraph—
- “related-party business expenditure” means any expenditure, other than capital expenditure, which gives rise, directly or indirectly, to income of a person related to C;
 - “relevant profits”, for an accounting period, means the total profits of C for that period calculated in accordance with generally accepted accounting practice (disregarding any capital gains or losses), but before any deduction for interest or tax;
 - “relevant operating expenses” of C means operating expenses of C other than—
 - (a) the cost of goods sold, and
 - (b) related-party business expenditure;
 - “scheme” means any scheme, arrangements or understanding of any kind whatever, whether or not legally enforceable, involving one or more transactions;
 - “UK-connected gross income” means the gross income derived, directly or indirectly, from persons who are within the charge to United Kingdom tax for all or part of the accounting period;
 - “UK-connected related-party business expenditure” means related-party business expenditure which gives rise, directly or indirectly, to income of a person within the charge to United Kingdom tax in respect of that income;
 - “United Kingdom tax” means income tax or corporation tax;
- and paragraph 12D(3) (persons “related” to C) applies for the purposes of this paragraph as it applies for the purposes of paragraph 12D(2)(f).
- (8) In the case of a company which is within the charge to United Kingdom tax only because it carries on a trade in the United Kingdom through a permanent establishment there, for the purposes of sub-paragraph (7)—
- (a) the gross income derived from that company is so much of the gross income as is attributable to that establishment, and
 - (b) the income received by that company is such of its income as is attributable to that establishment.

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12F Finance income and relevant IP income

- (1) The requirement of this paragraph is that not more than 5% of C's gross income for the accounting period falls within sub-paragraph (2).
- (2) Gross income falls within this sub-paragraph to the extent that it is—
 - (a) finance income, or
 - (b) relevant IP income.
- (3) "Finance income" means—
 - (a) any amount which in accordance with UK generally accepted accounting practice falls to be recognised as arising from a financial asset, and
 - (b) any return, in relation to an amount, which—
 - (i) is produced for C by an arrangement to which C is party, and
 - (ii) is economically equivalent to interest,except to the extent that the return is taken into account in determining an amount within paragraph (a).
- (4) "Relevant IP income" means royalties and receipts of a similar nature arising from intellectual property.
- (5) For the purposes of sub-paragraph (3)(b), the amount of a return is the amount which by virtue of the return would, in calculating C's chargeable profits, be treated under section 486B of CTA 2009 (disguised interest to be regarded as profit from loan relationship) as a profit arising to C from a loan relationship.
- (6) But, in calculating that profit for the purposes of sub-paragraph (5), sections 486B(7) and 486C to 486E of CTA 2009 are to be ignored.
- (7) In this paragraph—

"economically equivalent to interest" is to be construed in accordance with section 486B(2) and (3) of CTA 2009;

"financial asset" means a financial asset as defined for the purposes of UK generally accepted accounting practice or international accounting standards;

"intellectual property" is to be construed in accordance with paragraph 9(1A).

12G Gross income

- (1) References in this Part of this Schedule to C's gross income are to be construed in accordance with this paragraph.
- (2) C's gross income for an accounting period does not include—
 - (a) any distribution that would not be included in C's chargeable profits by reason of it being exempt for the purposes of Part 9A of CTA 2009 (see section 931A of that Act), or
 - (b) any amount that would be taken into account in computing chargeable gains if C were within the charge to corporation tax.

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- (3) C's gross income for an accounting period includes—
- (a) any income which accrues during that period to the trustees of a settlement in relation to which C is a settlor or a beneficiary, and
 - (b) any income which accrues during that period to a partnership of which C is a partner, apportioned between C and the other partners on a just and reasonable basis.
- (4) Where there is more than one settlor or beneficiary in relation to the settlement mentioned in sub-paragraph (3)(a), the income is to be apportioned between C and the other settlors or beneficiaries on a just and reasonable basis.
- (5) In this paragraph—
- “distribution” has the same meaning as in the Corporation Tax Acts (see Part 23 of CTA 2010);
 - “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 “partner” is to be read accordingly.

PART 2B

COMPANIES EXPLOITING INTELLECTUAL PROPERTY WITH LIMITED UK CONNECTION

12H Introductory

- (1) For the purposes of section 748(1)(bb), a company (“C”) is exempt for an accounting period if the requirements of this Part of this Schedule are satisfied.
- (2) The requirements are those imposed as to C's—
- (a) business establishment (see paragraph 12I),
 - (b) intellectual property business (see paragraph 12J),
 - (c) other business activities (see paragraph 12K),
 - (d) UK connection (see paragraph 12L), and
 - (e) finance income (see paragraph 12M).

12I Business establishment

- (1) The requirement of this paragraph is that throughout the accounting period C has a business establishment in the territory in which it is resident.
- (2) For the purposes of sub-paragraph (1)—
- (a) paragraph 5(2) to (5) (special rules about residence of the company) applies as it applies for the purposes of Part 2 of this Schedule, and
 - (b) paragraph 7 (meaning of “business establishment”) applies as it applies for the purposes of paragraph 6(1)(a).

12J Intellectual property business

- (1) The requirement of this paragraph is that C's main business, throughout the accounting period, consists of the exploitation of intellectual property which does not have a relevant UK connection.
- (2) For the purposes of sub-paragraph (1), if any part of C's main business consists of the exploitation of intellectual property which has a relevant UK connection, that part is to be ignored if it is an insignificant part of C's main business.
- (3) Intellectual property has a relevant UK connection if—
 - (a) at any time during the accounting period or the 6 years immediately preceding that period, it has been held by a person resident in the United Kingdom, or
 - (b) activities relating to the creation, maintenance or enhancement of the intellectual property (other than activities of an incidental or insignificant nature) have been carried on by a person who for some or all of the period—
 - (i) beginning when the activities were first carried on by the person, and
 - (ii) ending at the end of the accounting period,was related to C and within the charge to United Kingdom tax.

12K Other business activities

- (1) The requirement of this paragraph is that—
 - (a) C does not, at any time during the accounting period, carry on any activities otherwise than in the course of its main business, or
 - (b) if it carries on any such activities ("secondary activities"), the secondary activities condition is met.
- (2) The secondary activities condition is that either—
 - (a) the secondary activities do not, at any time during the accounting period, constitute a substantial part of the activities of C's business taken as a whole, or
 - (b) section 748(1)(b) or (ba) would apply to prevent an apportionment under section 747(3) falling to be made as regards that period, if C's business consisted only of the secondary activities carried on by it during the accounting period.

12L UK connection

- (1) The requirement of this paragraph is that C does not have a significant connection with the United Kingdom during the accounting period.
- (2) C has a significant connection with the United Kingdom during the accounting period if—
 - (a) all or a substantial proportion of C's gross income for that period consists of income from the exploitation of intellectual property

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which derives from persons within the charge to United Kingdom tax, or

- (b) during that period C incurs expenditure (other than expenditure of an incidental or insignificant nature) on—
- (i) R&D sub-contractor payments, or
 - (ii) the creation, development or maintenance of relevant intellectual property,

and that expenditure forms part of the income of a person who for some or all of that period is related to C and within the charge to United Kingdom tax.

- (3) In this paragraph—

“R&D sub-contractor payment” means a payment made by C to another person in respect of research and development contracted out by C to that person;

“relevant intellectual property” means intellectual property which does not have a relevant UK connection (see paragraph 12J(3)) and which C exploits in the course of its main business.

12M Finance income

The requirement of this paragraph is that not more than 5% of C’s gross income for the accounting period consists of finance income (within the meaning of paragraph 12F(3)).

12N Interpretation of Part 2B

- (1) For the purpose of this Part of this Schedule—

“intellectual property” is to be construed in accordance with paragraph 9(1A);

“United Kingdom tax” means corporation tax or income tax;

and paragraph 12G (meaning of “gross income”) applies as it applies for the purposes of Part 2A of this Schedule.

- (2) For the purposes of this Part of this Schedule a person is “related” to C at a particular time if at that time—

- (a) the person is connected or associated with C,
- (b) the person has a 25 per cent assessable interest in C in the case of the accounting period of C in which that time falls (within the meaning of paragraph 6(4C)), or
- (c) if C is a controlled foreign company in the accounting period in which that time falls by virtue of subsection (1A) of section 747, the person is connected or associated with either or both of the two persons mentioned in that subsection.

- (3) In the case of a company which is within the charge to United Kingdom tax only because it carries on a trade in the United Kingdom through a permanent establishment there—

- (a) for the purposes of paragraph 12J(3)(b), the activities carried on by the company are such of the activities as are carried on through that establishment,

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- (b) for the purposes of paragraph 12L(2)(a), the income derived from that company is such of the income so derived as is attributable to that establishment, and
- (c) for the purposes of paragraph 12L(2)(b), the income of that company is such of its income as is attributable to that establishment.”