

FINANCE ACT 2014

EXPLANATORY NOTES

INTRODUCTION

Sections 293 & 294: Controlled Foreign Companies: Qualifying Loan Relationships

Summary

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

Details of the Sections

5. Section 293 contains amendments to Part 9A TIOPA.

Section 293

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

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UK connected companies for the purpose of making the comparison required by new subsection 371IH(9A)(c) (i) and (ii).

10. New subsection 371IH(9D) requires that it is assumed that if the relevant arrangement had not been made then at all times after the relevant time the UK creditor relationship referred to by subsection 371IH(9A)(a) would have continued and had the same terms as it had at the relevant time. The relevant time is defined in new section 371IH(9E).
11. New subsection 371IH(9E) defines the terms used in new subsection 371IH(9A) as follows. A “corporation tax accounting period” is an accounting period for corporation tax purposes. “The relevant time” is the time immediately before the time when a relevant arrangement is made, or if earlier, the time when the UK creditor relationship ends. “Relevant UK credits” and “relevant UK debits” are defined as the credits and debits which a UK connected company has under the rules in Parts 5 or 7 CTA 2009 (loan relationships and derivative contracts), which include credits and debits to which Part 5 applies by virtue of Part 6 CTA 2009. A “UK connected company” is a UK resident company which is either connected with the CFC, or was connected with a company with which the CFC is connected.
12. Example:

A UK parent company has lent £100 million to a US subsidiary company. Interest of £5 million is received annually and subject to corporation tax as part of the profits of the UK parent company. The UK parent company enters into an arrangement in order to transfer the loan made to the US subsidiary to a new CFC in exchange for shares in the CFC. The relevant UK credits of the UK parent company are reduced as a result of the arrangement compared to what they would have been if the existing loan had continued on the same terms, and it is established that a main purpose of the arrangement made was to achieve this reduction. The arrangement therefore falls within new section 371(IH)(9A). Accordingly, the creditor relationship of the CFC cannot be a qualifying loan relationship by virtue of new section 371(IH)(9B). The profits of £5 million arising in the CFC in respect of its creditor relationship with the US company fall within Chapter 5 CFC charge gateway for non-trading finance profits, but cannot benefit from the partial or full exemption under Chapter 9. The overall effect is that the interest that was previously subject to corporation tax becomes subject to a CFC charge so that there is no change in the amount of UK tax paid.
13. Subsection 2 provides for the commencement of the new rules, stating that new subsections 371IH(9A), (9B), (9C), (9D) and (9E) apply to relevant arrangements which are made on or after 5 December 2013.

Section 294

14. Subsection 1 amends subsection 371IH(10)(c) (exclusions from the definition of qualifying loan relationships), replacing the phrase “wholly or mainly used” with “used to any extent (other than a negligible one)”. This sub-section provides that a loan cannot be a qualifying loan relationship where it is used to repay third party debt of a non-UK resident group company and that debt is effectively replaced with new UK debt, as part of an arrangement where one of the main purposes is to obtain a tax advantage for any person. The rule is directed at arrangements that give rise to an increase in debt in the UK whether provided by a UK third party or by a non-UK resident person.
15. In modifying the wording to say “...the relevant loan is *used to any extent (other than a negligible one)* to repay wholly or partly another loan...” it will apply in circumstances where there is a larger intra-group loan, so that the element that is applied to repay the external debt of the non-UK resident group company is a minority of the total amount of the loan.

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16. Subsections 2 to 5 provide for commencement. Subsection 2 states that the amendments to section 371IH(10)(c) will have effect for accounting periods of CFCs beginning on or after 5 December 2013.
17. Subsection 3 stipulates that the modified section 371IH(10)(c) will also apply to accounting periods of the CFC which begin before 5 December 2013, but end on or after that date. Such an accounting period is termed “the straddling period”. Sections 3, 4 and 5 apply the amended section 371IH(10)(c) to such periods, so as to exclude the profits arising after 5 December 2013 from the qualifying loan relationship profits of the CFC.
18. Subsection 4(a) provides that any apportionment for qualifying loan relationship profits of accounting periods which straddle 5 December 2013 should be made in accordance with section 1172 of CTA 2010 (an apportionment on a time basis). Where a time basis apportionment produces a result that is unjust or unreasonable, subsection 4(b) provides for apportionment on a just and reasonable basis.
19. Subsection 5 specifies that the profits from the qualifying loan relationships apportioned to the period falling on or after 5 December 2013 are to be excluded from the CFC’s qualifying loan relationship profits.

Background Note

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