These notes refer to the Finance Act 2014 (c.26) which received Royal Assent on 17 July 2014

FINANCE ACT 2014

EXPLANATORY NOTES

INTRODUCTION

Section 39: Tax Treatment of Financing Costs and Income

Summary

1. This section makes amendments to the "worldwide debt cap" (WWDC) legislation which places certain limitations on the deductibility of interest and similar expenses in computing corporation tax where the combined funding expenses of the UK members of a group exceed the funding expenses of the group as a whole. The changes clarify the position in cases where a group includes entities that do not have ordinary share capital. The measure also makes a minor change to the power to make regulations relevant to the potential impact of the provisions on whole business securitisations.

Details of the Section

2. Subsection (1) provides that Chapter 10 of Part 7 of the Taxation (International and Other Provisions) Act 2010 (TIOPA) is amended.

3. Subsection (2) amends subsection 345(7) TIOPA and inserts new subsections 345(8) to 345(10).

4. Amended subsection 345(7) TIOPA allows the meaning of 75% subsidiary in subsection 345(6)(a) for the purposes of the WWDC to be determined by reference to the definitions in Chapter 3 of Part 24 of the Corporation Tax Act 2010 (CTA 2010). It also allows for the provisions of Chapter 6 of Part 5 of CTA 2010 to be applied in determining the extent to which the ultimate parent is beneficially entitled to the profits or assets of a UK group company for the purposes of subsections 345(6)(b) or (c). In each case this is subject to the modifications set out in new subsections 345(8) and 345(9). These modifications are designed to have the following overall effects.

5. The definition of a 75% subsidiary is widened, in its application to the WWDC legislation, such that a company without share capital can be a 75% subsidiary of the ultimate parent. Also, in dealing with indirect subsidiaries, ownership can be traced through entities that do not have share capital.

6. A UK group company can be a relevant group company, even if it is not a 75% subsidiary, where the ultimate parent is beneficially entitled to 75% of the profits available for distribution by the company or 75% of the net assets available for distribution in a winding up.

7. These changes put it beyond doubt that the ultimate parent's beneficial entitlement to profits or assets can be traced through any intermediate company, entity, trust or arrangement.

8. In particular, new subsection 345(8) TIOPA provides that sections 169 to 182 of CTA 2010 do not apply for the purposes of the WWDC legislation. These provisions, which are primarily designed to ensure that 75% subsidiaries with shares carrying variable or

complex rights are not artificially included in a group relief group, are not required in the context of the WWDC.

9. One consequence of new subsection 345(9)(a) is that it ensures that a UK group company that does not have ordinary share capital, such as a company limited by guarantee, is capable of being a relevant group company. It introduces the term “corresponding ordinary holding”, defined in new subsection 345(10).

10. New subsection 345(9)(b) makes it clear that, in applying the rules in Chapter 6 of Part 5 or Chapter 3 of Part 24 of CTA 2010, ownership or beneficial entitlement to distributable profits can be traced through entities that do not have ordinary share capital in the same way as they might be traced through companies with ordinary share capital.

11. New subsection 345(9)(b) provides that, when ownership or beneficial entitlement is traced in this way, the holders of a “corresponding ordinary holding” (see below) are treated in the same way as holders of ordinary shares. Accordingly, the corporation tax rules which determine the profits and assets of a company available for distribution, and the rules on indirect ownership of shares apply to “corresponding ordinary holdings” in the same manner as they do to holdings of ordinary shares.

12. New subsection 345(10) defines a “corresponding ordinary holding”. The key feature of such a holding is that it conveys economic rights corresponding to those conveyed by a holding of ordinary shares, without regard to the legal form of the holding or any instruments that might comprise that holding. For example, a foreign partnership may have different classes of interests: preferred interests that convey rights to only a fixed amount of profit or percentage return on capital and residual interests that convey the rights to a share of the residual profit or surpluses on asset disposals. A holding of residual interests would be considered to be a corresponding ordinary holding, whereas a holding of preferred interests would not.

13. Subsection (3) amends section 353A(4) TIOPA to the effect that regulations made under the section may require certain conditions be met before an election to transfer liability can be made. For instance, regulations may require company A, a party to a capital market arrangement, to meet conditions such as being required to provide security over its assets before it is permitted to make an election under regulations made under section 353A.

Background Note

14. Finance Act 2009 introduced a package of changes to the taxation of companies on their foreign profits. One of these measures limits the interest and other finance expenses that can be deducted in computing the corporation tax payable by UK members of a worldwide group of companies, and is commonly referred to as the worldwide debt cap (WWDC).

15. The rules broadly operate by requiring UK groups to compare their UK financing costs, as calculated under the rules, with the finance costs of their worldwide group. If the UK costs exceed the worldwide costs then the excess is disallowed and the UK companies do not get any relief for the excess.