EXPLANATORY MEMORANDUM TO

THE CONTROLLED FOREIGN COMPANIES (EXCLUDED TERRITORIES) REGULATIONS 2012

2012 No. 3024

1. This explanatory memorandum has been prepared by HM Revenue & Customs ("HMRC") and is laid before the House of Commons by Command of Her Majesty.

2. Purpose of the instrument

2.1 The Regulations provide a list of excluded territories for the purposes of the excluded territories exemption ("ETE") and set out a further requirement for the ETE to apply. They also provide a modified ETE exemption which will apply in specified cases provided certain requirements are met.

3. Matters of special interest to the Select Committee on Statutory Instruments

3.1 The Regulations replace the Controlled Foreign Companies (Excluded Companies) Regulations (SI 1998/3081) which are revoked from the date the Regulations take effect.

4. Legislative Context

4.1 Subsections (2) and (3) of section 371KB of Part 9A of the Taxation (International and Other Provisions) Act 2010 (TIOPA)[1] detail the powers used by the Regulations. The powers are being used for the first time in making the Regulations. The powers allow for, the list of excluded territories to be provided, the requirements in subsections (1)(b) and (c) to be disapplied or modified, and specification of further requirements which need to be met in order for the ETE to apply to a controlled foreign company ("CFC").

4.2 The ETE is an exemption from the CFC provisions in Part 9A of TIOPA ("the CFC legislation").

4.3 The CFC legislation itself will, in certain circumstances, impose a charge (equivalent to corporation tax) on UK resident companies in respect of overseas companies which are controlled from the UK and in which the UK resident company has a specified interest. There are various exemptions from the CFC legislation including the ETE. The ETE broadly replaces the Excluded Countries Exemption (mainly found in SI 1998/3081) which was part of the previous CFC legislation (mainly found in Chapter IV of Part XVII of ICTA 1988).

[1] Inserted by Schedule 20 to the Finance Act 2012.

5. Territorial Extent and Application

5.1 The Regulations apply to all of the United Kingdom.

6. European Convention on Human Rights

As the Regulations are subject to negative resolution procedure and do not amend primary legislation, no statement is required.

7. Policy background

- ***What is being done and why***

7.1 The CFC legislation, of which the ETE is part, is anti-avoidance legislation, the aim of which is to prevent the diversion of UK profits to low tax territories. Reform of the CFC legislation is intended to improve the UK's international tax competitiveness whilst retaining adequate protection for the UK's corporate tax base.

7.2 Within the CFC legislation the purpose of the ETE is to exempt those CFC's that pose a low risk to the UK corporate tax base due to their territory of residence. The ETE will broadly exempt CFCs resident in territories where the CFC's income is taxed at a rate similar to the UK main corporation tax rate.

7.3 If the ETE applies for a CFC's accounting period all of its profits will be exempted from charge under the CFC legislation.

- ***Consolidation***

7.4 Not applicable

8. Consultation outcome

8.1 A consultation document was published in June 2011 on proposals for wider reform of the previous CFC legislation and representations on this were extensive. A further consultation on the draft CFC legislation (including the Regulations) took place from 6 December 2011.

8.2 As part of the consultation process HMRC (along with HM Treasury) met with various interested parties including business and their representatives and actively sought their input into the proposals and the draft CFC legislation.

8.3 The outcome of the consultation was that business wanted the ETE to have as many territories as possible on the excluded territories list in the Regulations and to have only a few targeted general conditions. It was considered that this would make the exemption simpler to apply than the previous Excluded Countries Exemption which the ETE replaces. Business also wanted to have included in the ETE a modified exemption comprising a very short list of excluded territories for which fewer conditions would apply. Further information can be found in the Tax Information and Impact Note published on HMRC website.

9. Guidance

9.1 Guidance on the operation of the ETE, of which the Regulations form part, will be included in the wider update of the International Manual concerning the CFC legislation. The Guidance will be published on the HMRC website in due course.

10. Impact

10.1 The impact on business, charities or voluntary bodies is negligible as those businesses already claiming exemption under the Excluded Countries Exemption will in the vast majority of cases still be eligible for the ETE.

10.2 The impact on the public sector is nil.

10.3 A Tax Information and Impact Note covering this instrument was published on 21 March 2012 alongside the draft CFC rules now contained in Part 9A of TIOPA 2010 and is available on the HMRC website at http://www.hmrc.gov.uk/thelibrary/tiins.htm. It remains an accurate summary of the impacts that apply to this instrument.

11. Regulating small business

11.1 The Regulations apply to small business in the same way as larger business. It will however be larger businesses that have CFCs as part of their group structure which will fall within the CFC legislation. No special approach for small business is therefore necessary.

12. Monitoring & review

12.1 HMRC will keep the Regulations under review to ensure that they meet the policy objectives set out above in section 7.

13. Contact

13.1 Mary Sharp at HMRC Tel: 0207 147 2656 or 0207 147 0797 (email: mary.sharp@hmrc.gsi.gov.uk) can answer any queries regarding the Regulations.