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

FINANCE ACT 2014

EXPLANATORY NOTES

INTRODUCTION

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

Details of the Sections

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 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.