

## **Controlled foreign companies regime**

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### **Who is likely to be affected?**

UK resident companies that hold an interest in controlled foreign companies (CFC).

### **General description of the measure**

A package of measures that will:

- extend the scope of the new CFC rules so they apply to profits from all assets leased under finance leases, including hire purchase and similar types of contract;
- limit the amount of double taxation relief (DTR) for UK companies that form part of certain arrangements involving the routing of a loan from one CFC to another CFC through a UK company;
- ensure that references to the interpretation of certain accounting practices are consistent throughout the new CFC rules; and,
- introduce a minor consequential amendment to the arbitrage anti-avoidance rules.

### **Policy objective**

The new CFC rules, introduced in Finance Act 2012, will better reflect the way that businesses operate in a global economy whilst maintaining adequate protection against artificial diversion of UK profits. The changes introduced by this measure will ensure the new CFC rules work as intended to protect the UK's corporation tax base.

### **Background to the measure**

The new CFC rules were introduced by FA 2012 as part of the corporate tax roadmap.

## **Detailed proposal**

### **Operative date**

The changes to the CFC rules will have effect for CFCs with accounting periods beginning on or after 1 January 2013, which is the commencement date of the new CFC rules as a whole. The new limitation to DTR will apply to UK companies that derive profits from a conduit financing arrangement involving CFCs with accounting periods beginning on or after 1 January 2013. The changes in the new CFC rules to ensure consistent interpretation of generally accepted accounting practice and the consequential change to the arbitrage rules have effect from 1 January 2013.

### **Current law**

The new CFC rules were introduced by FA 2012 and incorporated as Part 9A TIOPA 2010. The rules are anti-avoidance provisions designed to prevent UK tax resident companies artificially diverting UK profits to controlled companies in overseas jurisdictions.

## Proposed revisions

Legislation will be introduced in Finance Bill 2013 to make the following amendments:

Firstly, the current definition of 'relevant finance lease' (section 371VA TIOPA) will be amended to widen its scope by including making assets available by way of a hire purchase or similar contract. The scope of the new CFC rules will be extended to include profits derived from relevant finance leases of any assets apart from those that are loan relationships.

Secondly, those parts of the new CFC rules that require consideration of accounting treatment where accounts have not been prepared under either UK generally accepted accounting practice or international accounting standards will be made by reference to international accounting standards.

Thirdly, Part 2 of TIOPA will be amended to limit the amount of DTR that can be claimed as a credit by a UK company (or given as a deduction if no claim for credit is made) when one or more UK companies form part of an arrangement whereby a loan is made from one CFC to another CFC that is the ultimate debtor in relation to that loan. Where one or more UK companies form part of a conduit in such an arrangement the DTR by credit or deduction will be limited to the amount of corporation tax that would be due in respect of the UK corporation tax profits that arise from that arrangement.

Finally, a minor consequential change will be made to section 236(4) TIOPA to ensure the arbitrage rules continue to work as intended. The change ensures that the arbitrage rules do not apply merely as a result of the application of another territory's CFC rules that are similar to those within Part 9A TIOPA.

## Summary of impacts

Exchequer impact (£m)	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
	nil	nil	nil	nil	nil	nil
	This measure is not expected to have an Exchequer impact. This measure supports the Exchequer in its commitment to protect revenue.					
<b>Economic impact</b>	The measure will remove some specific opportunities for corporation tax avoidance. As such it acts to remove a potential competitive imbalance within certain sectors of the economy.					
<b>Impact on individuals and households</b>	The measure is not expected to have any impact on individuals and households					
<b>Equalities impacts</b>	The measure is not expected to have any equalities impact.					
<b>Impact on business including civil society organisations</b>	This measure addresses two substantive planning opportunities. These would constitute an unfair advantage and in removing that there will be no impact on the normal commercial transactions of businesses and civil society organisations.					
<b>Operational impact (£m) (HMRC or other)</b>	The measure is not expected to have any operational impact since the amendments impact on a very small number of companies.					
<b>Other impacts</b>	Other impacts have been considered and none have been identified.					

**Monitoring and evaluation**

The new CFC regime, including the amendments made within this measure, will be reviewed to ensure they are operating as intended.

**Further advice**

If you have any questions about these changes, please contact Nick Shepherd on 020 7147 2689 (email: [nick.shepherd@hmrc.gsi.gov.uk](mailto:nick.shepherd@hmrc.gsi.gov.uk)).

**1 Controlled foreign companies etc**

Schedule 1 makes provision in relation to CFCs etc.

## SCHEDULES

## SCHEDULE 1

Section 1

## CONTROLLED FOREIGN COMPANIES

*Relevant finance leases etc*

- 1 Part 9A of TIOPA 2010 (controlled foreign companies) is amended as follows.
- 2 Chapter 5 (the CFC charge gateway: non-trading finance profits) is amended as follows.
- 3 In section 371ED (arrangements in lieu of dividends) in subsection (1) omit “(other than a relevant finance lease)”.
- 4 (1) Section 371EE (leases to UK resident companies etc) is amended as follows.
  - (2) In subsection (2)(b)(i) for “which is the subject of the lease” substitute “(“the relevant asset”) which is the subject of the lease or making (directly or indirectly) an arrangement which would fall within subsection (3)”.
  - (3) After subsection (2) insert—
    - “(3) An arrangement would fall within this subsection if—
      - (a) the arrangement would meet one or both of the following requirements—
        - (i) it would not be a relevant finance lease;
        - (ii) it would not involve the CFC, and
      - (b) under the arrangement the other company would (directly or indirectly) purchase rights to use the relevant asset.”
- 5 Chapter 22 (supplementary provision) is amended as follows.
- 6 In section 371VA (definitions) for the definition of “relevant finance lease” substitute—
  - ““relevant finance lease” is to be read in accordance with section 371VIA,”.
- 7 (1) Section 371VG (finance profits) is amended as follows.
  - (2) In subsection (1) for paragraph (b) substitute—
    - “(b) which are included in the CFC’s assumed total profits for the accounting period in question and which—
      - (i) arise from a relevant finance lease, but
      - (ii) are not trading profits.”
  - (3) In subsection (4)(b) omit “an arrangement which would be”.

- 8 (1) Section 371VH (interests in companies) is amended as follows.
- (2) In subsection (9) omit the second paragraph.
- (3) After subsection (10) insert –
- “(10A) For the purposes of subsection (9), if for any relevant period accounts for a loan creditor are not prepared in accordance with international accounting standards or UK generally accepted accounting practice, any question relating to generally accepted accounting practice is to be determined in relation to the loan creditor for that period by reference to generally accepted accounting practice in relation to accounts prepared in accordance with international accounting standards.”
- 9 After section 371VI insert –
- “371VIA Relevant finance leases**
- (1) In this Part “relevant finance lease” means an arrangement falling within subsection (2) or (3).  
(An arrangement which is a loan relationship of any company does not fall within either of those subsections.)
- (2) An arrangement falls within this subsection if –
- (a) it provides for an asset to be leased or otherwise made available by a person (“the lessor”) to another person, and
- (b) in accordance with generally accepted accounting practice, it falls (or would fall) to be treated in the accounts of the lessor, or of a person connected with the lessor, as a finance lease or a loan.
- (3) A hire-purchase, conditional sale or other arrangement relating to an asset falls within this subsection if it does not fall within subsection (2) but is of a similar character to an arrangement which would fall within that subsection.
- (4) If for any relevant period accounts for a person are not prepared in accordance with international accounting standards or UK generally accepted accounting practice, any question relating to generally accepted accounting practice is to be determined for the purposes of this section in relation to that person for that period by reference to generally accepted accounting practice in relation to accounts prepared in accordance with international accounting standards.
- (5) In this section “accounts”, in relation to a company, includes accounts relating to two or more companies of which that company is one.”

*Limit on double taxation relief in cases involving qualifying loan relationships of CFCs*

- 10 Part 2 of TIOPA 2010 (double taxation relief) is amended as follows.
- 11 Chapter 2 (double taxation relief by way of credit) is amended as follows.
- 12 In section 42 (limit on credit against corporation tax) after subsection (4) insert –

“(5) See also section 49A which contains an additional limit on credit allowed in certain cases involving CFCs.”

13 After section 49 insert –

**“49A Limit on credit in cases involving qualifying loan relationships of CFCs**

- (1) This section applies if –
- (a) a claim is made under Chapter 9 of Part 9A (controlled foreign companies: exemptions for profits from qualifying loan relationships) in relation to an accounting period (“the relevant period”) of a CFC (“the creditor CFC”),
  - (b) in the relevant period, the creditor CFC has a qualifying loan relationship in relation to which another CFC is the ultimate debtor by virtue of section 371IG(4) or (5), and
  - (c) a UK resident company (“the relevant UK company”) has loan relationship credits which arise in the relevant period from –
    - (i) loan B (see section 371IG(3)(b)), or
    - (ii) loans out of which loan B is wholly or partly funded (directly or indirectly).

- (2) So far as any credit allowed under section 18(2) to the relevant UK company is referable to loan relationship credits falling within subsection (1)(c) which arise in an accounting period of the relevant UK company, the credit must not exceed –

$$R \times S$$

where –

R has the same meaning as in section 42(2), and

S is –

- (a) the relevant UK company’s share of the relevant profit amount (see subsection (4)), or
- (b) if only X% of the total amount of the loan relationship credits falling within subsection (1)(c) arises in the accounting period, X% of the relevant UK company’s share of the relevant profit amount.

(If the amount given by the formula above is nil, no credit is allowed.)

- (3) The limit on credit contained in subsection (2) is in addition to the limit given by section 42(2).
- (4) Take the following steps to determine the relevant profit amount and the relevant UK company’s share of that amount.

*Step 1*

Determine the total amount of the loan relationship credits which arise in the relevant period from loan B to the person who made loan B.

*Step 2*

Deduct from the amount determined at step 1 above the credits from the creditor CFC’s qualifying loan relationship determined at step 1 in section 371IF for the relevant period.

The result is the relevant profit amount.

*Step 3*

On a just and reasonable basis, apportion the relevant profit amount amongst all the persons falling with subsection (5) (although the amount apportioned to a person may be nil).

The relevant UK company's share of the relevant profit amount is the amount apportioned to it (and is nil if no amount is apportioned to it).

- (5) The following persons (apart from the creditor CFC) fall within this subsection –
- (a) the person who made loan B, and
  - (b) any person who has made or received a loan out of which loan B is wholly or partly funded (directly or indirectly).
- (6) In this section –
- (a) references to loan B do not include any part of loan B –
    - (i) which loan A (see section 371IG(3)(a)) is not made and used to fund, or
    - (ii) in relation to which the requirement of section 371IG(3)(c) is not met,
  - (b) “loan relationship credit” means, in relation to a person, a credit which the person has under Part 5 of CTA 2009 or would have were the person a UK resident company within the charge to corporation tax, and
  - (c) “loan” has the same meaning as it has in Chapter 9 of Part 9A.”
- 14 (1) In Chapter 3 (miscellaneous provisions) section 112 (deduction from income for foreign tax (instead of credit against UK tax)) is amended as follows.
- (2) After subsection (3) insert –
- “(3A) Subsection (3B) applies if –
- (a) the requirements of section 49A(1)(a) to (c) are met,
  - (b) amounts have been paid in respect of non-UK tax on loan relationship credits falling within section 49A(1)(c) which arise in an accounting period of the relevant UK company, and
  - (c) apart from subsection (3B),  $Z$  would exceed  $R \times S$ , where –  
 $Z$  is –
    - (i) the total amount of any reductions under subsection (1) for amounts paid in respect of that non-UK tax, less
    - (ii) the total amount of any increases under subsection (3) for payments made by reference to that non-UK tax, and $R$  and  $S$  have the same meaning as in section 49A(2).
- (3B) The total amount of the reductions under subsection (1) is to be reduced so that  $Z$  equals  $R \times S$ .”
- (3) In subsection (6) for “subsection (1)” substitute “this section”.

*Tax arbitrage: consequential amendment*

- 15 In Part 6 of TIOPA 2010 (tax arbitrage) in section 236 (deduction schemes involving hybrid entities) for subsection (4) substitute –
- “(4) Condition B is not met just because the party’s profits or gains are subject to a charge under the law of a territory outside the United Kingdom (by whatever name known) which is similar to the CFC charge (see Part 9A).”

*Commencement*

- 16 The amendments made by this Schedule are treated as having come into force on 1 January 2013.

**EXPLANATORY NOTE**

**CONTROLLED FOREIGN COMPANIES (CFC) REGIME MEASURE  
NUMBER 2024**

**SUMMARY**

1. This Clause and Schedule ensures the Controlled Foreign Companies (CFC) regime at Part 9A of the Taxation (International and Other Provisions) Act 2010 (TIOPA) operates as intended. It makes amendments to Part 2 (double taxation relief), Part 6 (tax arbitrage) and Part 9A (controlled foreign companies) TIOPA.
2. The above amendments will come into force on 1 January 2013.

**DETAILS OF THE SCHEDULE**

**Relevant finance leases**

3. Paragraph 3 of the Schedule removes the limitation in section 371ED(1) TIOPA that excludes non-trading finance profits arising from a relevant finance lease from the scope of section 371ED TIOPA. This ensures that all non-trading finance profits that arise from either arrangements made as an alternative to paying dividends, or from relevant finance leases are within the scope of Chapter 5 of Part 9A TIOPA.
4. Paragraph 4 amends section 371EE(2)(b) TIOPA so that the alternative scenario considered is both the purchase (directly or indirectly) of an asset, and an arrangement falling within new section 371EE(3) TIOPA. That section deals with an arrangement whereby a UK company purchases rights to use an asset (such as a licence to use a patent). It provides for two counterfactuals:
  - An arrangement that involves purchasing the rights to use the relevant asset from a person other than the CFC (and so the arrangement could involve a relevant finance lease provided the CFC was not the lessor); or
  - An arrangement that involves purchasing the rights to use the asset, but not by way of a relevant finance lease (and so the counterfactual could be an arrangement such as a licence granted by the CFC).
5. Paragraph 5 and 6 refer to the new definition of “relevant finance lease” in new section 371VIA TIOPA.

6. Paragraph 7 amends the definition of finance profits in section 371VG TIOPA.
7. Paragraph 8 amends section 371VH(9) TIOPA and inserts new section 371IH(10A) TIOPA to make clear that in determining whether a person has an interest in a CFC by virtue of a loan relationship with embedded derivatives in a situation where accounts have not been prepared in accordance with generally accepted accounting standards then that issue will be determined on the assumption that accounts have been prepared in accordance with international accounting standards.
8. Paragraph 9 inserts new section 371VIA (relevant finance leases) TIOPA. The new section has the effect of including all finance leases over assets and arrangements that are of a similar character, within the definition of relevant finance lease.
9. New section 371VIA(1) provides that relevant finance leases are the arrangements that fall within new subsections (2) and (3) and specifies that loan relationships of any company are not included within the definition of relevant finance lease.
10. New section 371VIA(2) identifies arrangements where a lessor provides an asset to be leased, or otherwise made available, to another person. These arrangements are relevant finance leases for the purposes of Part 9A TIOPA where, in accordance with generally accepted accounting practice, they are treated in the accounts of the lessor, or a person connected with the lessor, as a finance lease or loan.
11. New section 371VIA(3) provides that the term relevant finance lease shall also include certain hire-purchase, conditional sale or other arrangements. These arrangements are included where they do not fall within new section 371VIA(2), but are of a similar character to the arrangements that would fall within new section 371VIA(2).
12. New section 371VIA(4) stipulates for the purposes of new section 371VIA, that where the accounts of a person are not drawn up in accordance with generally accepted accounting practice (which is specified as either UK GAAP or international accounting standards), any question that has to be considered by reference to generally accepted accounting practice is determined by assuming that the accounts of the person are prepared in accordance with international accounting standards.
13. New section 371VIA(5) makes clear that for the purposes of this section the “accounts” of a company include accounts that relate to two or more companies of which that company is one and so includes consolidated accounts.

**Limit on double taxation relief in cases involving qualifying loan relationships of CFCs**

14. Paragraphs 10 to 14 of the Schedule limit double taxation relief given by way of credit against corporation tax, or by deduction in calculating corporation tax profits in certain circumstances involving qualifying loan relationships of CFCs.
15. Paragraph 12 inserts new section 42(5) TIOPA that makes clear that the limitation provided by new section 49A TIOPA is an additional limitation to double taxation relief to that provided for by section 42 TIOPA.
16. Paragraph 13 inserts new section 49A after section 49 TIOPA. New sections 49A(1)(a)-(c) identify the circumstances under which this section will apply.
17. New section 49A(1)(a) provides that section 49A will take effect only if a claim has been made under Chapter 9 of Part 9A TIOPA in relation to an accounting period of the CFC. A Chapter 9 claim is for partial or full exemption from a CFC charge for certain non-trading finance income profits that arise on a loan relationship between two non-UK resident group companies.
18. New section 49A(1)(b) stipulates that in that period there needs to be a qualifying loan relationship between the two CFCs (the “Creditor CFC” in respect of which a Chapter 9 claim has been made and an “Ultimate Debtor” CFC).
19. New section 49A(1)(c) requires that the UK resident company (“the relevant UK company”) has profits which include loan relationship credits in the period which originate directly or indirectly from “Loan B”. “Loan B” is defined by the new CFC rules. Where “Loan B” is made by a person out of funds provided directly as a loan from the “Creditor CFC” or where for example another person is interposed between the “Creditor CFC” and the first person and provides the funds in such a way that the loan made by the “Creditor CFC” would be a qualifying loan relationship (as defined in Chapter 9 of Part 9A), then the condition in new section 49A(1)(c) is met.
20. New section 49A(2) limits entitlement to double taxation relief by way of credit under Part 2 TIOPA to a relevant UK company that has loan relationship credits that have been subject to foreign tax. This section further limits the credit entitlement by reference to the formula:

RxS

Where:

R is the rate of Corporation Tax payable by the relevant UK company (before any credit relief); and

S is (a) the relevant UK company's share of the relevant profit amount; or

(b) the proportion of the relevant UK company's share of the relevant profit amount that arises in the relevant period.

21. New section 49A(3) states that the limit introduced by this new section applies in addition to the limits to credit against corporation tax specified in section 42(2).

22. New section 49A(4) provides the steps for the calculation of the relevant UK company's share of the relevant profit amount for the relevant period ("S" in the above example).

Step 1 - ascertains the loan relationship credits in the period from "Loan B"

Step 2 - establishes the loan relationship credits of the Creditor CFC's qualifying loan relationship and subtracts this sum from the amount established in Step 1 above. This is the relevant profit amount.

Step 3 - the relevant profit amount is allocated between all the persons in the lending chain in a way that seems the most reasonable.

#### Example

CFC A (Creditor CFC) lends (Loan A) to UK Company (Relevant UK Company) that in turn lends (Loan B) to CFC B (Ultimate Debtor CFC). In the relevant period:

- UK Company has interest receivable of 100 on Loan B from CFC B (Ultimate debtor CFC),
- CFC A (CFC Creditor) has interest receivable of 90.

The relevant profit amount is therefore 10 which would be apportioned to UK Company in the lending chain.

23. New section 49A(5) determines the persons amongst whom the relevant profit amount is apportioned. It includes the person who made "Loan B" and any other person in the lending chain between the Creditor CFC and the "Loan B" lender. It includes anyone who has made or received a loan in that lending chain, for example a person who has received a loan and then passes the funds on as an investment by way of preference shares in another company in the

lending chain. It also includes persons who only provide part of the funds for “Loan B”.

24. New sections 49A(6)(a)(i) and (ii) provide a limitation to the amount of “Loan B” where that loan is not wholly funded by “Loan A” provided by the Creditor CFC, or where “Loan B” is used to make a further loan to another person.
25. New section 49A(6)(b) defines “loan relationship credit” in line with a loan relationship credit under Part 5 of CTA 2009. The definition is extended to persons in the lending chain who are not liable to corporation tax, by assuming they are a UK resident company within the charge to corporation tax.
26. New section 49A(6)(c) defines “loan” for the purposes of this section.
27. Paragraph 14 inserts new sections 112(3A) and (3B) TIOPA. These new sections modify the amount of foreign tax that is allowed as a deduction from the income subject to that foreign tax, where a claim for relief by way of credit is not made.
28. New sections 112 (3A)(a) and (b) set out the first two conditions for new section 112(3B) to apply. New subsection (a) mirrors the conditions which trigger S49A to act. New subsection (b) applies if the loan relationship credits received by the relevant UK company have had foreign tax paid in respect of those credits.
29. New section 112 (3A)(c) sets out the third condition for new section 112(3B) to apply. It modifies the amount of foreign tax that can be deducted in section 112(1) TIOPA to take account of any repayment of the foreign tax, reducing the amount to be considered for deduction to the net amount after any repayment. It does this by defining Z as that net amount and compares whether Z exceeds the amount RxS, where:

R is the rate of Corporation Tax payable by the Company (before any credit relief); and

S is (a) the UK resident company’s share of the relevant profit amount or

(b) the proportion of the UK resident company’s share of the relevant profit amount that arises in the relevant period,

as determined in accordance with new section 49A TIOPA.

If Z were for example nil (because all the foreign tax had been repaid), then Z would not exceed RxS and so the third condition would not be met. In that case the amount of foreign tax deducted in section 112(1) would be nil because of the application of section

112(3) TIOPA. Alternatively if Z equals the amount of the foreign tax deducted (because there is no repayment of foreign tax) then the third condition is met and the limitation in new section 112(3B) applies.

30. New section 112(3B) limits the deduction from income for foreign tax by reference to the formula RxS.
31. In section 112(6) “this section” is inserted in place of “subsection 1”.

**Tax arbitrage: consequential amendment**

32. Paragraph 15 substitutes new subsection 236(4) in TIOPA. It ensures condition B is brought into line with the introduction of Part 9A TIOPA. Condition B, which assists in determining whether the scheme is a deduction scheme for the purposes of the arbitrage rules, shall not be failed solely because the profits of the company in question are treated as taxable on another person by a rule in a territory outside the UK, which is similar to Part 9A TIOPA.

**Commencement**

33. Paragraph 16 states that the amendments made by this Schedule come into force on 1 January 2013.

**BACKGROUND**

34. The new CFC rules at Part 9A TIOPA (introduced in Finance Act 2012) better reflect the way that businesses operate in a global economy whilst maintaining adequate protection against artificial diversion of UK profits. This Schedule amends Part 9A in order to ensure the CFC rules operate as intended and continue to protect the UK's corporation tax base. It also amends Part 2 of TIOPA to limit the amount of double tax relief available to UK companies where they are involved in certain financing arrangements involving CFCs.
35. The Schedule addresses two tax planning opportunities, and in addition makes minor consequential amendments to provide consistency of interpretation of accounting practice in the new CFC rules and to make sure a limitation in the arbitrage rules continues to apply. The amendments:
  - expand the definition of ‘relevant finance lease’ within Part 9A, to ensure certain hire purchase business is within scope of the new CFC rules and so that the definition applies to any asset (other than an asset which would be a loan relationship);
  - limit the amount of double taxation relief that can be claimed by UK companies that form part of certain arrangements involving

the routing of a loan from one CFC to another CFC through one or more UK companies;

- ensure that references to the interpretation of certain accounting practices in Part 9A are consistent; and
- introduce a minor consequential amendment to the arbitrage anti-avoidance rules in Part 6 of TIOPA.

36. If you have any questions about this change, or comments on the legislation, please contact Nick Shepherd on 020 7147 2689 (email: [Nick.Shepherd@hmrc.gsi.gov.uk](mailto:Nick.Shepherd@hmrc.gsi.gov.uk)).