



HM Revenue
& Customs

**Guidance on avoidance schemes involving
the transfer of corporate profits**

Technical Note

- Further guidance on legislation published on 19 March 2014

Guidance note on measure announced at Budget: avoidance schemes involving the transfer of corporate profits

Summary of effects of measure

1. This measure was announced at Budget 2014, with immediate effect. It applies where companies in the same group enter into arrangements where payments are made, directly or indirectly, of all or a significant part of the profits of the business of a company in the group to another company in the group.
2. In those circumstances, the company from which profits were transferred is taxed as though the transfer had not taken place, for example, if a deduction had been claimed for a transfer of profits, then the effect of the clauses is that the profits transferred are added back for corporation tax purposes. It applies where the arrangements were entered into for tax avoidance purposes.
3. This note expands on the guidance note published on 19 March 2014, with more details and some additional examples.

Background: why the measure was introduced

4. The measure follows the announcement of section 695A CTA 2009 on 5 December 2013, to be introduced in Finance Bill 2014 with effect from the date of announcement.
5. That measure was intended to close down an avoidance scheme. In the scheme, a company enters into a derivative contract known as a total return swap, with a parent company or another group company, generally located in a tax haven. Under the contract, all of the profits of the company are paid away in return for much smaller payments back. A deduction is claimed for the payment under the contract, leaving little or no profit chargeable to tax.
6. The Government considers that it is not acceptable for groups to move profits around the group in this way to avoid UK tax. S695A aimed to prevent this by providing that where there is a payment in substance of the profits of a company to another company in the same group, directly or indirectly, then the former company will be assessed as though the transfer had not taken place.
7. HM Revenue & Customs (HMRC) subsequently became aware of avoidance schemes not involving derivatives that could achieve the same outcome, that is, to try and obtain a deduction for a payment designed in substance to move profits earned in the UK to a tax haven, or otherwise to divert profits to generate a tax advantage, and s1305A will block those schemes. The target remains payments which are in effect distributions of profits, but disguised in

various ways with the aim of obtaining a deduction from profits for a distribution.

8. S1305A is additionally intended to block arrangements where a payment which is essentially a receipt of pure income profits is diverted to a different group company with the aim of avoiding tax.

Main points of the legislation

9. The full legislation is in s1305A CTA 2009, and can be found at Appendix 1. An outline of the main points is given here.
10. S1305A(1) sets out when the legislation applies. It applies where two companies in the same group are party to any arrangements. Group is defined in subsection (6), using the definition in s357GD of CTA 2010. This is a wide definition of group, which is appropriate for an anti-avoidance measure of this nature.
11. Subsection (1)(c) gives more detail of the targets. The arrangements must result in what is in substance a payment from one Group Company to another of all or a significant part of the profits of the business of A.
12. More details of profits caught by the clause are set out in paragraphs 19 - 24 below.
13. Subsection (1)(d) provides that the main purpose or one of the main purposes of the arrangements is to secure a tax advantage for any person involving the profit transfer, whether by circumventing s695A or otherwise. More details of the interaction with s695A are at paragraph 29 below. The meanings of tax advantage and main purpose are discussed further at paragraphs 34-36 below.

Sub-sections (2) and (3)

14. Subsection (2) provides that where subsection (1) applies, A's profits are to be calculated for corporation tax purposes as though the profit transfer had not occurred.
15. Subsection (3) sets out in more detail what the consequences are of subsection (2) applying. These can involve denying a deduction, in similar circumstances to those where s695A would take effect, but where a derivative is not involved. They can also involve adding a sum back to A's profits where an amount which is pure income profit has been transferred.
16. Subsection (3) is intended to be a guide to the application of subsection (2), rather than an expansion.

17. Unlike s695A, s1305A contains no provision to exempt from tax any credits or receipts that correspond to disallowed amounts. This is appropriate as the measure is an anti-avoidance measure, and contains a motive test.
18. Where a sum paid to another group company is partly a transfer of profits, but contains other components, then the add back will be limited to the amount of the profit transfer. For example, if a payment is made under the arrangements of an amount which includes a profit transfer but also includes an allowable deduction, s1305A would apply only to the profit transfer.

Meaning of profits

19. The target of the legislation is any arrangement that has the overall effect that all or a significant part of the profits of a company are paid to another company. The legislation refers to this payment as a 'profit transfer'.
20. However, it would not apply where the arrangements have the effect of moving amounts within a group that do not amount to an in-substance transfer of the profits of a business. (See the examples at paragraph 64 onwards for illustrations of this point.)
21. The clause will deny tax deductions for amounts that in substance represent distributions of the profits of the company, because in substance they are paid after profits have been earned rather than being deductions incurred in the making of profits. By contrast, payments genuinely incurred in earning the profits, on commercial terms, do not result in a profit transfer since these expenses need to be deducted in determining what the profits are, and the clause is similarly not intended to catch individual transactions which may feature in arriving at profits.
22. Where the payments concerned are, for example, genuinely payments in respect of goods, services, or the use of tangible or intangible assets provided by B, s1305A will not apply as the payments were made in arriving at the profits of A rather than being a transfer of part of A's profits.
23. However, a payment would not be outside the scope of s1305A just because it features as a deduction in the profit and loss account or elsewhere. All of the circumstances surrounding the payment will be considered.
24. Arrangements which are, or have similar effects to, insurance, reinsurance, guarantees provided by 1 company for services provided by another, profit swaps, derecognition, non-recognition, or profit transfers through skewed partnership profit shares are potentially within scope of the rule if these arrangements are being used to achieve a profit transfer, and a tax avoidance purpose is present.

Transfer of profits

25. This measure followed the introduction of s695A. That measure was intended to target payments which were in reality distributions of profits, but were disguised as derivatives. S1305A has the same target, but will catch schemes which do not involve derivatives, but achieve similar effects.
26. However, it will also catch other arrangements where profits are diverted from a company with the intention of avoiding corporation tax. For example, if a UK company is due to receive a lump sum of pure income profit on which it will be taxed, and arranges for it to be paid instead to a group company located in a tax haven, then that sum will be a target for s1305A.
27. To be a target for s1305A, the sum must still be a profit - it would not apply if receipts are diverted which do not amount to profits. Similarly, it would not apply if profit-generating capacity - eg the business itself, or part of it - had been unconditionally transferred from company A to company B (see para 51).
28. The tax advantage must involve the profit transfer. It would not therefore apply because of indirect effects of the transfer. For example, if profits were distributed (eg as a non-deductible dividend) to a company in a jurisdiction with a lower tax rate, and invested there, this would not be a target for s1305A, although the long term effect might be that income arises from those investments which would be taxed at a lower rate than would have been the case in the UK.

Interaction with s695A

29. Subsection (1)(d) states that the tax advantage may arise by circumventing section 695A, or otherwise. This is intended to be a pointer that steps taken on or after 5 December 2013 in response to s695A are clearly caught, while making clear that this is not the only target.
30. This means that a company formerly using a scheme now caught by s695A which enters into other arrangements which involve a profit transfer will be clearly caught by the measure. However, it will also apply to companies entering into a scheme for the first time, and also any old schemes (ie entered into before 5 December 2013) which did not use a scheme involving a total return swap or other derivative.
31. Where s695A applies to a derivative arrangement, s1305A cannot apply. It is technically possible that s1305A could apply to profit transfers involving derivatives in tax avoidance cases if s695A does not apply because of the specific exclusion in s695A(1)(e). However, the mere fact of falling outside s695A as a result of the exclusion in s695A(1)(e) would not of itself indicate that this is an arrangement aimed at getting a tax advantage.
32. As with section 695A, s1305A does not apply unless there is a transfer of profits, so a contract, such as a hedging arrangement, which did not in itself transfer profits is not within s1305A. S1305A has a tax avoidance test rather

than an exclusion for the ordinary course of business, but the section is not intended to apply a more rigorous test than that in s695A(1)(e).

33. Subsection (5) provides that where the requirements of s695A are met, then s1305A does not apply. This is to provide a priority rule where otherwise both clauses could apply so as to ensure that the disallowance is made under s695A.

Main purpose and tax advantage

34. The legislation does not define what is meant by 'main purpose' or 'one of the main purposes'. These expressions are to be given their normal meaning as ordinary English words. They have to be applied objectively, having regard to the full context and facts.
35. It will usually be clear whether trying to obtain a tax advantage is 'the main purpose' of a particular arrangement. Such would be the case, for example, where the arrangement would not have been carried out at all were it not for the opportunity to obtain the tax advantage, or where any non-tax objective was secondary to the benefit of obtaining the tax advantage.
36. For the purposes of the measure, tax advantage takes the definition in s1139 CTA 2010, which includes, among other categories, a relief from tax or increased relief from tax, a repayment of tax or an increased repayment of tax, the avoidance or reduction of a charge to tax or an assessment to tax, and the avoidance of a possible assessment to tax. In forming a view on whether the tax advantage test is met, HMRC would take into account all of the circumstances around a particular transfer.

Commencement

37. The clauses take effect in respect of payments made on or after 19 March 2014, whenever the arrangements were entered into.

Procedures

38. Use of the legislation will be subject to the supervision of a specialist team within HMRC. As is usual for new legislation, HMRC will be willing to give advice on the application of the legislation.
39. To fall within the legislation, there are 2 requirements. There must be a transfer of profits, and it must have as its main purpose or 1 of its main purposes obtaining a tax advantage.

40. HMRC will give clearances on whether a profit transfer has occurred, as defined in s1305A(1)(c).
41. On the question of whether the main purpose test in s1305A(1)(d) is satisfied, HMRC will not be able to give clearances as they would not be in a position to comment on the motives of those undertaking the transactions. However, HMRC would be willing to provide a view on whether there is considered to be a low risk of the provision applying.

Particular situations/issues

Securitisations and financing arrangements

42. The first draft of the guidance note contained advice on securitisations and how s1305A could apply to them. We have been asked to provide further advice on whether the transactions involved in a securitisation could fall within s1305A.
43. A securitisation company, if covered by the provisions of the Taxation of Securitisation Companies Regulations 2006 (SI2006/3296) will only be liable to tax under those regulations on the fee or margin that they receive from their participation in the securitisation transaction. Thus there is no deduction for which relief could be denied under s1305A. The company will be subject to the anti-avoidance test in those regulations.
44. In other cases, of financing transactions similar to securitisations, it is likely that profits as such are not being transferred, but rather that different streams of payments on different assets are being exchanged. It is unlikely therefore that a transfer of profits will be involved.
45. In some cases, a securitisation or similar transaction may include a provision for residual profits to be brought back to a parent company or member of the group, so there is likely to be a transfer of profits at that stage. Where this involves the transfer of profits to the UK, then obviously this will not amount to obtaining a tax advantage.

Transfer pricing and advance pricing agreements

46. In circumstances where, under genuine arrangements without an avoidance purpose, a non-arm's length price is paid by A for goods, services, or the use of tangible or intangible assets provided by B, s1305A will not apply as the payments were made in earning the profits of A rather than being a transfer of part of A's profits. The transfer pricing rules will apply to change the price of the transaction to the arm's length price.

47. However s1305A might apply in unusual cases where the transactions lack commercial substance or are obviously artificial, and the main purpose or one of the main purposes of entering into them is to secure a tax advantage for any person, notwithstanding that the taxpayer has determined or claims to have determined, an arm's length price for those arrangements.
48. As part of its model of direct engagement with customers, HMRC discusses commercial arrangements and confirms where appropriate that it does not regard particular arrangements as tax avoidance. HMRC does not provide advice on arrangements that it considers to involve tax avoidance.
49. Where HMRC has agreed an Advance Pricing Agreement (APA) the effect of that agreement is that profits are taxed in the 'correct' tax jurisdiction and there is then no transfer from A to B of part of A's profits so s1305A will not apply.
50. The usual transfer pricing governance arrangements within HMRC will apply in respect of any potential challenge under the transfer pricing legislation at Part 4, TIOPA10.

Transfer of assets

51. A transfer or diversion of the profits of Company A to Company B, as explained above, is an arrangement that results in A not realising (whether through not receiving them in the first place, or by paying them away) for CT purposes the profit attributable to that business. However, s1305A does not apply to potential profits transferred because the underlying business has been transferred from A to B. This is not a transfer of the profit away from the business that generates it.
52. If, as part of an unconditional arrangement, an asset is transferred with the associated income stream, then this would not amount to a transfer of profits, but to a different type of transaction. S1305A would not apply, although other anti-avoidance legislation would potentially be in point.
53. By contrast, if an asset which is due to give rise to income is transferred on a temporary basis, such that the temporary holder receives pure income profits, then s1305A could apply.
54. The temporary transfer of an asset might well result in A retaining economic ownership of the underlying asset while transferring its profits to B. If so the legislation could apply, subject to the tax avoidance requirement.
55. The legislation is unlikely to apply, however, apply to intra-group repos or stock loans made in the ordinary course of a group's business. If the transferor is compensated for any income arising on the asset during the course of the repo or stock loan, the overall effect of the arrangements would in any case not amount to a profit transfer.

56. HMRC has been asked to clarify whether the transfer of income streams legislation in part 16 of CTA 2010 (section 752-757) has priority over s1305A. In practice, if the transfers of income stream rules apply, there is very unlikely to be any tax advantage, so s1305A could not apply. In the event of any doubt over the matter, HMRC would be willing to advise.

Reinsurance

57. Where a company has entered reinsurance arrangements within a group, for example, quota share reinsurance or excess of loss reinsurance, as part of ordinary commercial arrangements, then this would not normally form the target of this measure. It is only in circumstances where the normal commercial motives for reinsuring are absent from the arrangements that the measure would be applied.
58. A payment of premium from a group company to a reinsurer would not normally be considered in itself to be a payment of profits, but rather a price that the cedant pays the reinsurer for the ongoing service of indemnifying the cedant against its insurance losses.
59. One factor which is likely to be taken into account in deciding where to locate an intra-group re-insurance company will be the tax impact. This element of tax planning in itself will not mean that the arrangements are caught by s1305A provided that the arrangements are commercial.
60. The application of the section will depend on all of the circumstances. As motive is a matter of fact, it is not possible to provide in guidance for all different circumstances, but HMRC would be able to advise on the application of the legislation in particular cases.

Industrial and provident societies

61. Dividends paid by industrial and provident societies (such as co-operative societies) are treated as interest (s499 CTA 2009). For example, this could be relevant where dividends are paid by a subsidiary co-operative society to a parent co-operative society, both of which are UK resident.
62. It might be said that tax advantages arise through the payment of such dividends. For example, non trade losses brought forward can be used against the dividend receipt with the dividend being deductible in the payer. This could be significant depending on the size of the dividend as compared to profits.
63. However, these dividends are not within the scope of s1305A, as legislation specifically provides for the tax treatment of dividends.

Examples

Example 1 deduction for transfer of profits: an example of one type of arrangement the legislation was intended to cover

64. A company was formerly using a total return swap to move profits from a profitable UK subsidiary to a fellow group company located in a tax haven. On 5 December 2013 it wound up that scheme. It then entered a scheme on 31 December 2013 in which arrangements not involving a total return swap were used to move profits to the subsidiary in the tax haven. The new scheme involves contracts falling outside the derivatives code which have the same overall effect of producing a deduction for a sum which is really a transfer of profits.
65. This arrangement will be caught by the new measure, and subsection 3(a) will apply, so that any profits transferred will be added back to the profits of the company on or after 19 March 2014.

Example 2 - franchise arrangements

66. A franchisee makes various payments to the franchisor as payment for its right to use the name and for various amenities.
67. In most cases the franchisor and franchisee would not be in the same group. However, even if they were, these payments would be payments made in earning the profits and not payments of part of the profits and thus would not be caught, provided that normal commercial arrangements were entered into, and not tax avoidance arrangements.

Example 3 - licence payments

68. A company based in the US licenses a UK group company to sell its product in the UK. The UK company may make payments under the licence agreement based on a percentage of turnover and these would not be profit transfer arrangements.
69. Where there is an avoidance purpose the anti avoidance provision in the corporate intangibles legislation would act to counteract the avoidance.

Example 4 - profit split method involving the UK

70. Intangibles are legally held by a UK group company and a non-UK group company provides services in enhancing the intangibles. These services are

substantial and quantifiable. The non-UK company is rewarded by a percentage of the profits arising from the exploitation of those intangibles.

71. The nature of the payment is that of an expense incurred in arriving at the taxable profits of the UK company. Consequently, s1305A would not be considered to apply.

Example 5 - transfer of asset

72. A creditor loan relationship, and the associated interest income, are unconditionally sold from a UK group company A to a group company B in another jurisdiction.
73. This transfer would not fall within s1305A as there is not in substance, a payment (directly or indirectly) of all or a significant part of the profits of the UK company selling the asset.
74. As a consequence of the transfer, amounts arise to B that would otherwise have arisen to A. However as the sale of the asset means that A no longer has any economic interest in that asset, these amounts cannot be regarded as payments from A to B of part of A's own profits. Consequently the legislation cannot apply.

Example 6 - Transfer of asset (2)

75. An intangible fixed asset together with the associated income stream are transferred from a UK group company to a group company in another jurisdiction.
76. As with example 5, this transfer would not fall within s1305A as there is not in substance, a payment (directly or indirectly) of all or a significant part of the profits of the UK company selling the asset.
77. The asset is further developed in the overseas jurisdiction and, in a future period, a licence is entered into with the UK for the use of that asset. These services are substantial and quantifiable. Under the licence, the non-UK company is rewarded by a percentage of the profits arising from the exploitation of those intangibles.
78. The effect of the payment is to reduce the taxable profits of the UK company. However, all profits end up in the right place and the analysis is the same as in example 5.

Example 7 - contracts undertaken by non-resident companies

79. An online retailer 'fulfils' contracts in the UK, but the contracts are concluded with a non-resident group company. Provided that the profit arises offshore and does not involve a transfer of profits, the legislation cannot apply. If the arrangement does effect a transfer of profits, the legislation will apply if tax avoidance is involved.

Example 8 - profits diverted: a further example of an arrangement the legislation is intended to catch

80. A company is entitled to receive a compensation payment which is in effect pure income profit of the company. It arranges for this payment to be made to a different company in the group, for tax avoidance reasons.
81. This will be caught by the measure from 19 March 2014, and the effect of subsection (3)(b) is that a sum equal to the compensation payment will be added back to the profits of the company.

Example 9 - cessation of taxable payments

82. Company B is the parent entity of Company A and is resident in a tax haven. Prior to the arrangement being entered into, Company A receives taxable amounts from Company B in respect of B's use of an asset owned by A. The income is pure income profit. Company A pays dividends equal to those profits back to Company B, for which it receives no tax deduction.
83. Company A and B then agree that A will no longer pay dividends and in return B will no longer have to pay the income; however use of the asset continues as before.
84. The arrangement results in what is in substance a payment from A to B of a part of A's profit: in effect A is still making these profits and paying them back to company B, but under an offsetting arrangement.
85. This arrangement would be caught by the legislation if there is a tax avoidance purpose. If there is no tax avoidance purpose transfer pricing will require adjustment of Company A's profit to recognise an arm's length payment for the use of its asset by Company B.

Example 10 - charitable subsidiaries

86. Charities (which are normally tax exempt) often set up subsidiaries to carry on trading activities. The subsidiary then returns the profit it makes to the charity by making a payment under a deed of covenant or under the Gift Aid scheme. The payment is tax deductible for the subsidiary and is tax exempt for the charity. This type of arrangement is not of itself considered to be tax avoidance since the subsidiary and the charity are using statutory relief for charities in the way intended by Parliament

Appendix 1: legislation

Avoidance schemes involving the transfer of corporate profits

(1) In Chapter 1 of Part 20 of CTA 2009 (general calculation rules: restriction on deductions), after section 1305 insert.

1305A avoidance schemes involving the transfer of corporate profits

(1) This section applies if

- (a) 2 companies (.A. and .B.) are party to any arrangements (whether or not at the same time),
- (b) A and B are members of the same group,
- (c) the arrangements result in what is, in substance, a payment (directly or indirectly) from A to B of all or a significant part of the profits of the business of A or of a company which is a member of the same group as A or B (or both) ('the profit transfer'), and
- (d) the main purpose or one of the main purposes of the arrangements is to secure a tax advantage for any person involving the profit transfer (whether by circumventing section 695A (disguised distribution arrangements: derivative contracts) or otherwise).

(2) A's profits are to be calculated for corporation tax purposes as if the profit transfer had not occurred.

(3) Accordingly.

- (a) if (apart from this section) an amount relating to the profit transfer would be brought into account by A as a deduction in that calculation, no deduction is allowed in respect of that amount, and
- (b) A's profits are to be increased by so much of the amount of the profit transfer as is not an amount to which paragraph (a) applies (whether or not the profits transferred would be A's profits apart from the arrangements).

(4) For the purposes of this section a company is a member of the same group as another company if it is (or has been) a member of the same group at a time when the arrangements mentioned in subsection (1) have effect.

(5) Where in relation to arrangements involving one or more derivative contracts the requirements of section 695A(1)(a) to (e) are met, nothing in this section applies in relation to any debit in respect of any of those contracts.

(6) In this section.

'arrangements' includes any scheme, arrangement or understanding of any kind, whether or not legally enforceable, involving a single transaction or two or more transactions;
'group' has the meaning given by section 357GD of CTA 2010;
'tax advantage' has the meaning given by section 1139 of CTA 2010.

(2) The amendment made by this section has effect in relation to payments made on or after 19 March 2014.