

EXPLANATORY MEMORANDUM TO

THE CORPORATE INTEREST RESTRICTION (FINANCIAL STATEMENTS:
GROUP MISMATCHES) REGULATIONS 2017

2017 No. XXXX

1. Introduction

- 1.1 This explanatory memorandum has been prepared by Her Majesty's Revenue & Customs (HMRC) and is laid before the House of Commons by Command of Her Majesty.
- 1.2 This memorandum contains information for the Select Committee on Statutory Instruments.

2. Purpose of the instrument

- 2.1 These Regulations make provision for transitional adjustments in connection with the new Corporate Interest Restriction (CIR) rules introduced in [Finance Act 2017]. ([FA2017]) which added a new Part 10 of the Taxation (International and Other Provisions) Act 2010 (TIOPA 2010).
- 2.2 In particular, they address two scenarios where timing differences between the group accounts and entity accounts can lead to an unwarranted restriction under those elements of the rules that are based on the group's financial statements.

3. Matters of special interest to Parliament

Matters of special interest to the Select Committee on Statutory Instruments

- 3.1 These Regulations have effect in relation to periods of account beginning on or after 1 April 2017 to match the commencement of the CIR rules. This will ensure the CIR rules will operate as intended from the start.
- 3.2 Authority for the limited retrospective effect of these amending Regulations can be found at [section 495(2) of TIOPA 2010].

Other matters of interest to the House of Commons

- 3.3 As this instrument is subject to the negative resolution procedure and has not been prayed against, consideration as to whether there are other matters of interest to the House of Commons does not arise at this stage.

4. Legislative Context

- 4.1 The CIR rules follow OECD recommendations on how to tackle Base Erosion and Profit Shifting (BEPS). They will help to counter aggressive tax planning whereby multinationals arrange their interest expenses to minimise UK taxable profits.
- 4.2 They work by capping the amount of relief for interest expense and other financing costs (referred to as 'tax-interest' amounts) to 30% of UK taxable earnings before interest, depreciation and amortisation (referred to as 'tax-EBITDA'). The fixed ratio debt cap within the new rules will ensure the deduction for net tax-interest expense

does not exceed the ‘adjusted net group-interest expense’ for the worldwide group based on its consolidated accounts.

- 4.3 Higher relief is available for commercially highly leveraged groups through the group ratio method. This allows a ‘group ratio percentage’ to be substituted for the 30% figure. This percentage is based on the ratio of ‘qualifying net group-interest expense’ to ‘group-EBITDA’ for the worldwide group based on its consolidated accounts.
- 4.4 The Regulations are being made under [section 495 TIOPA 2010] and this is the first use of that power.

5. Extent and Territorial Application

- 5.1 The extent of this instrument is the United Kingdom.
- 5.2 The territorial application of this instrument is the United Kingdom.

6. European Convention on Human Rights

- 6.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

What is being done and why

- 7.1 The Regulations address two situations where differences can arise between the way amounts are recognised in the group’s financial statements and how they are recognised for accounting purposes by any member of the group.
- 7.2 The first situation concerns the case where, on commencement of the CIR rules, a loan relationship is recognised in the worldwide group’s financial statements such that
 - it is subject to fair value accounting or fair value adjustments as part of a fair value hedge in the group accounts; and
 - is recognised at the amortised cost basis of accounting in the financial statements of the issuer company.
- 7.3 In this case, the Regulations treat the financial statements for the worldwide group as being prepared on the basis that they recognise the loan relationship on the amortised cost basis of accounting.
- 7.4 The second situation concerns the case where the group had an external loan that was bought into the group prior to commencement of the CIR rules, but where it still exists as between two group members.
- 7.5 There is likely to be a gain or loss on the ‘redemption’ of the loan from the group accounts perspective. However, at the entity level the two companies will record the loan at different carrying values. The effect of this is that no gain or loss is typically recognised at the entity level at the time the debt is bought into the group. Instead the gain or loss is recognised gradually over the remainder of the term of the debt as a differential in the effective interest rate on the two sides of the loan.
- 7.6 In this case, the Regulations treat the financial statements of the worldwide group as being prepared on the basis that the gain or loss on the derecognition of the loan is spread over the remainder of the term of the loan on a just and reasonable basis.

Consolidation

- 7.7 This is the first set of Regulations made under this power and so the question of consolidation does not arise.

8. Consultation outcome

- 8.1 [The draft Regulations are published for comment until 26 May 2017].

9. Guidance

- 9.1 HMRC guidance in the Corporate Finance Manual will be amended.

10. Impact

- 10.1 The amending Regulations are expected to have a negligible impact overall and no impact on charities or voluntary bodies is anticipated. The overall CIR measure will have an impact on large business and more information on this can be found at paragraph 10.3.

- 10.2 There is negligible impact on the public sector.

- 10.3 A Tax Information and Impact Note (TIIN) covering this instrument was published on 5 December 2016 alongside the draft clauses and explanatory notes for the Finance Bill 2017 and is available on the website at:

<https://www.gov.uk/government/publications/corporation-tax-tax-deductibility-of-corporate-interest-expense/corporation-tax-tax-deductibility-of-corporate-interest-expense>.

It remains an accurate summary of the impacts that apply to this instrument.

11. Regulating small business

- 11.1 The legislation does not affect small business because the CIR rules do not apply to groups with less than £2 million of net interest expense per annum.

12. Monitoring & review

- 12.1 The policy will be monitored through information obtained through collaborative engagement with customers and enquiries into self-assessments.

13. Contact

- 13.1 Oli Jones at HMRC Telephone: 03000 541970 or email: oli.jones@hmrc.gsi.gov.uk can answer any queries regarding the instrument.