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Controlled Foreign Companies: an Update and Future Proposals





History

Why reform foreign profits?

- Identified by business as a key area for reform. Rules were viewed as uncompetitive and uncertain

Key milestones

- 2007 discussion document
- First part of foreign profits reform delivered in FA2009
- Second part reform new CFC rules (aiming FB 2011)





Foreign profits FA 2009 package

1. Dividend exemption
 - Credit to exemption system for foreign dividends – significant simplification
 2. Worldwide debt cap
 - Limited restriction on interest expense (world wide debt cap)
 3. Replacing treasury consent rules with post transaction reporting requirement
- Overall business welcomed package - increased the competitiveness of the UK





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CFC reform – where are we?

- CFC rules continue to be needed to protect the UK tax base
- The Government published a discussion document on CFC reform in January
- Aim of reform is to enhance competitiveness of UK whilst maintaining adequate protection of UK tax base
- Extensive consultation to date to input into proposals for framework, money and intellectual property. Need to ensure this continues.
- Aiming to publish more detailed proposals and draft legislation later in 2010 and to legislate in FB 2011





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Drivers for reform of CFCs

- Recognising and adapting to changes in the way that modern business operates globally
- Making the rules consistent with the recent changes to the taxation of foreign profits in line with a more territorial approach
- Targeting the rules as effectively as possible





Policy principles for CFC reform

- Modernise CFC rules to reflect current business practice
- Enhance competitiveness of UK whilst providing adequate protection of UK tax base
- Move to a more territorial approach
- Target artificial diversion of profit from UK
- Minimise compliance costs and provide taxpayers with certainty
- Compliance with EU law





Overarching framework

- Entity basis with hybrid elements
- Alternatives discounted
 - income streaming
 - single purpose test approach





Scope of regime

- Exclude intra-group transactions where no artificial diversion of profit from the UK
 - examples – property - non UK properties, appropriately funded
 - Re-insurance – non UK risks, appropriate level of capital
- Higher de-minimis test
- Reformed motive test
- Focus on low tax jurisdictions: options for new test
- Views on practical application





Monetary assets: Principles

- Allow groups to manage monetary assets in a way that best supports overall competitiveness
- While providing appropriate protection of the UK tax base
- Exempt management of monetary assets where there is low risk to UK tax base
- Target situations where UK funds used to invest in equity of overseas finance companies





Monetary assets: treasury and finance operations

- Distinction between treasury and finance operations
- Exemption for treasury operation companies – consult on scope of exemption
- Exemption for finance companies in low tax jurisdictions where company appropriately funded by reference to mix of debt:equity
- Consult on appropriate level of funding





Monetary assets: Excess cash

- Balanced package for monetary assets
- Non-trading income earned by a trading company in low-tax jurisdiction should be eligible for exemption if incidental or ancillary to trade
- Non trading income in excess of this limit subject to CFC charge
- Consult on approach and application of incidental/ancillary test





Intellectual property: Principles

Reflect a more territorial approach by:

- Refocusing on intellectual property (IP) transfers from the UK
- Recognising that IP can be managed offshore as a trading activity





Intellectual property: Transfer of IP from the UK

- Risk to UK tax base where artificial transfer of IP from the UK to low tax jurisdiction
- Focus on IP whose value is not readily ascertainable and that significantly increases in value post transfer
- Interaction with patent box
- Consult on mechanics of charge





Intellectual property: IP held outside the UK

- Exemption for IP that is actively managed outside UK
- Recognise that some activities could be sub-contracted and may not all be conducted in the CFC's territory
- Consult on appropriate characteristics





Intellectual property: IP not actively managed

- Focus on diversion of profit from the UK
- Provide exemption where no UK connection
- Consult on definition of UK connection, could include UK funding and UK royalty payments

