

Amendments to the Tax Treatment of Financing Costs and Income (Debt Cap)

Who is likely to be affected?

Large groups of companies that are subject to the debt cap.

General description of the measure

This measure will amend Part 7 of the Taxation (International and Other Provisions) Act 2010 (TIOPA), the rules commonly called the debt cap. It will resolve a number of issues that have arisen on the application of the debt cap rules.

Policy objective

It is designed to make the debt cap rules simpler to apply and eliminate situations where the rules apply unfairly.

Background to the measure

The debt cap legislation was introduced in Finance Act 2009. A number of changes have been made since its introduction to improve the way it applies. The measure was announced in Budget 2011 following which there was a period of consultation on a number of potential changes.

Detailed proposal

Operative date

The measure will have effect for the periods of account of worldwide groups ending on or after the date of Royal Assent to Finance Bill 2012.

Current law

The debt cap rules are contained within part 7 of TIOPA. The rules restrict the amount of interest that large groups can deduct for the purposes of corporation tax. The restriction is made by comparing the UK financing expenses of the group net of financing income with the amounts shown for finance costs in the consolidated accounts of the worldwide group. The computations involve identifying these figures in the accounts.

Proposed revisions

Legislation will be introduced in Finance Bill 2012. This will include the ability to opt-out of the de-minimis limits of the net financing deduction and net financing income amounts.

The changes also include rules to deal with:

- mergers, acquisitions and de-mergers of groups;
- dormant companies and the elections for companies to be treated as 'authorised companies' and treasury companies;
- an anti-avoidance provision; and,
- a power to make regulations to deal with the proposed changes in accounting standards for consolidated accounts.

In addition the Government expects to make regulations under the powers in section 336A TIOPA for mismatches arising from loans to a partnership and for asset backed pension contributions.

Overall the changes will assist in identifying third party debt within the consolidated accounts and assist the administration of the debt cap rules.

Summary of impacts

Exchequer impact (£m)	2011-12	2012-13	2013-14	2014-15	2015-16
	-	negligible	negligible	negligible	negligible
	The measure is expected to have a negligible impact on the Exchequer. Any impact will be set out at Budget 2012.				
Economic impact	It is expected that the economic impact will be nil. The majority of changes involve clarification of the current rules to ensure that the debt cap works as intended.				
Impact on individuals and households	There will be no impact on individuals and households as the measure only applies to large corporate groups.				
Equalities impacts	The measure will have no impact on the equality of groups with protected characteristics because it only applies to large groups of companies.				
Impact on business including civil society organisations	<p>The debt cap rules will only apply to large corporate groups of which we estimate there are 1,800, so small and medium enterprises and civil society organisations will be unaffected by the measure. The most recent debt cap measure in Finance (No.3) Act 2010 had no impact and we expect that there will be at most a negligible (beneficial) impact on large groups.</p> <p>The responses to the consultation question on the cost of making a de-minimis election were that it would be negligible.</p>				
Operational impact (£m) (HMRC or other)	There is no operational impact on HMRC.				
Other impacts	The potential for other impacts has been considered and none is foreseen.				

Monitoring and evaluation

This measure will be monitored through receipts and communications with taxpayer groups affected.

Further advice

If you have any questions about this change, please contact Lesley Hamilton on 020 7147 2564 (email: lesley.hamilton@hmrc.gsi.gov.uk) or Fiona Hay on 020 7147 2543 (email: fiona.hay@hmrc.gsi.gov.uk).

1 Tax treatment of financing costs and income

Schedule 1 contains provision about the tax treatment of financing costs and income.

SCHEDULE 1

Section 1

TAX TREATMENT OF FINANCING COSTS AND INCOME

- 1 Part 7 of TIOPA 2010 (tax treatment of financing costs and income) is amended as follows.
- 2 (1) Section 261 (application of Part) is amended as follows.
 - (2) In subsection (1), at the end insert –
“This is subject to subsections (1A) and (2).”
 - (3) For subsection (2) substitute –
 - “(1A) This Part does not apply to a period of account unless the worldwide group meets the requirements of paragraphs (a) and (b) of section 337(1) (meaning of “the worldwide group”) throughout that period.
 - (2) This Part does not apply to a period of account if the worldwide group is a qualifying financial services group in that period (see section 266).”
- 3 In section 262 (UK net debt of worldwide group for period of account of worldwide group), in subsection (4), for “dormant (within the meaning of section 1169 of the Companies Act 2006)” substitute “a dormant company”.
- 4 In section 276 (disallowance of deductions: appointment of authorised company for relevant period of account), after subsection (2) insert –
 - “(2A) In subsection (2), the reference to each company to which this Chapter applies does not include a company that is a dormant company throughout the relevant period of account.”
- 5 In section 280 (statement of allocated disallowances: requirements), after subsection (5) insert –
 - “(5A) An amount may not be specified in relation to a company under subsection (4)(b) if it arises at a time at which the company is not a relevant group company.”
- 6 In section 288 (exemption of financing income: appointment of authorised company for relevant period of account), after subsection (2) insert –
 - “(2A) In subsection (2), the reference to each company to which this Chapter applies does not include a company that is a dormant company throughout the relevant period of account.”
- 7 In section 292 (statement of allocated exemptions: requirements), after subsection (5) insert –
 - “(5A) An amount may not be specified in relation to a company under subsection (4)(b) if it arises at a time at which the company is not a UK group company.”
- 8 In Chapter 6 (tax avoidance), before section 306 insert –

“305A Schemes preventing this Part applying to a large group

- (1) This section applies in relation to a period of account of a large group of entities if, apart from this section, this Part would not apply in relation to that period because of a failure by the group to meet the requirement of section 337(1)(b) (the worldwide group must contain one or more relevant group companies) throughout that period.
 - (2) If conditions A and B are met, this Part applies to the group as it would have applied had the scheme mentioned in condition A not been entered into.
 - (3) Condition A is that—
 - (a) at or before the end of the period of account, a scheme is entered into, and
 - (b) the main purpose, or one of the main purposes, for which a person becomes or is party to the scheme is to secure that the requirement of section 337(1)(b) is not met by the group throughout that period.
 - (4) Condition B is that the scheme is not an excluded scheme.”
- 9 (1) Section 313 (the financing expense amounts of a company) is amended as follows.
- (2) In subsection (6), for “the same proportion” substitute “such proportion as is just and reasonable”.
 - (3) After that subsection insert—

“(6A) An amount may be reduced to nil under subsection (6).”
- 10 (1) Section 314 (the financing income amounts of a company) is amended as follows.
- (2) In subsection (6), for “the same proportion” substitute “such proportion as is just and reasonable”.
 - (3) After that subsection insert—

“(6A) An amount may be reduced to nil under subsection (6).”
- 11 In section 316 (group treasury companies), omit subsection (4).
- 12 (1) Section 329 (the tested expense amount) is amended as follows.
- (2) In subsection (3), omit “as a result of a transaction that takes place”.
 - (3) After subsection (5) insert—

“(6) But subsection (5) does not apply if an election under section 331ZA has effect for the period of account.”
- 13 (1) Section 330 (the tested income amount) is amended as follows.
- (2) In subsection (3), omit “as a result of a transaction that takes place”.
 - (3) After subsection (5) insert—

“(6) But subsection (5) does not apply if an election under section 331ZA has effect for the period of account.”

14 After section 331 insert –

“331ZA Elections disapplying sections 329(5) and 330(5)

- (1) The relevant reporting body of the worldwide group may elect that sections 329(5) and 330(5) are not to apply in relation to the group.
- (2) The election must specify –
 - (a) the first period of account of the worldwide group in relation to which it has effect, and
 - (b) the name and tax reference of –
 - (i) each company that is a UK group company at the time the election is made, and
 - (ii) any other company that was a UK group company at any time during the period beginning at the same time as that period of account and ending when the election is made.
- (3) An election has effect for the specified period of account and subsequent periods of account of the worldwide group (unless withdrawn under subsection (4) or replaced by a further election made in relation to the group).
- (4) The relevant reporting body of the worldwide group may withdraw an election with effect from the beginning of the period of account specified in the withdrawal.
- (5) “The relevant reporting body” means –
 - (a) if an appointment under section 288 has effect in relation to the specified period of account, the company appointed under that section, and
 - (b) if such an appointment does not have effect, the companies which are UK group companies at the relevant time, acting jointly.

But the companies within paragraph (b) do not include any company that is a dormant company throughout the specified period of account.
- (6) An election or withdrawal must –
 - (a) be made by notice in writing to an officer of Revenue and Customs, and
 - (b) be received by HMRC within 12 months of the end of the specified period of account.
- (7) The notice must be signed –
 - (a) in a case within paragraph (a) of subsection (5), by the appropriate person in relation to the company appointed under section 288, and
 - (b) in a case within paragraph (b) of that subsection, by the appropriate person in relation to each company within that paragraph.
- (8) For the purposes of this section –

“the appropriate person”, in relation to a company, means –

 - (a) the proper officer of the company, or

- (b) such other person as may for the time being have the express, implied or apparent authority of the company to act on its behalf for the purposes of this Part,
and subsections (3) and (4) of section 108 of TMA 1970 (responsibility of company officers: meaning of “proper officer”) apply as they apply for the purposes of that section; “relevant time” means –
 - (a) in the case of an election, the time the election is made, and
 - (b) in the case of a withdrawal of an election, the time the withdrawal is made;“specified period of account” means –
 - (a) in the case of an election, the period specified under subsection (2)(a), and
 - (b) in the case of a withdrawal of an election, the period specified under subsection (4).”
- 15 (1) Section 337 (meaning of “the worldwide group”) is amended as follows.
 - (2) The existing provision becomes subsection (1).
 - (3) After that subsection insert –
 - “(2) For the purposes of subsection (1), section 345(3) to (7) (meaning of “relevant group company”) has effect as if references to the worldwide group were to the group of entities mentioned in subsection (1).”
- 16 In section 339 (meaning of “ultimate parent”), in subsection (1), in paragraph (c) for the words from “an entity” to the end substitute “a partnership formed under the law of a territory outside the United Kingdom which would be a collective investment scheme if it were formed under the law of any part of the United Kingdom.”
- 17 After section 348 insert –

“348A Business combinations and periods of account

- (1) Subsections (2) applies where –
 - (a) a business combination or demerger occurs to which the worldwide group is party (“the relevant event”),
 - (b) as a result of the relevant event, there is a change in the identity of the ultimate parent of –
 - (i) the worldwide group, or
 - (ii) any other group which is party to the relevant event, and
 - (c) financial statements of the worldwide group are drawn up, or (in the absence of this section) would be treated as drawn up under section 348, for a period which begins before and ends after the relevant event (“the straddling period”).
- (2) This Part (apart from this section) applies as if –
 - (a) no financial statements of the worldwide group had been drawn up for the straddling period,
 - (b) section 348 did not apply to that period, and

- (c) IAS financial statements had been drawn up in respect of each the following –
- (i) the period beginning at the same time as the straddling period and ending immediately before the relevant event, and
 - (ii) the period beginning with the relevant event and ending at the same time as the straddling period.
- (3) For the purposes of this section –
- (a) “demerger” means a transaction by which one or more groups cease to be members of a group,
 - (b) a group is party to a business combination or demerger if the business combination or demerger affects one or more members of the group, and
 - (c) the reference to “IAS financial statements” is to be construed in accordance with section 348(5).”
- 18 In section 351 (expressions taking their meaning from international accounting standards), in subsection (1), before the entry for “effective interest method” insert –
- ““business combination”,”.
- 19 In section 353 (other expressions), at the appropriate place insert –
- ““dormant company” means –
- (a) a company that is “dormant” within the meaning of section 1169 of the Companies Act 2006, or
 - (b) a company of an equivalent description which is incorporated outside the United Kingdom, other than, in the case of paragraph (a), a company in respect of which adjustments fall to be made under section 147(3) or (5) (transfer pricing: tax calculations to be based on arm’s length not actual provision),”.
- 20 After section 353A insert –
- “353AA Power to make regulations where accounting standards change**
- (1) The Treasury may by regulations amend this Part to take account of any relevant accounting change resulting from a change in accounting standards.
 - (2) “Relevant accounting change” means a change in the way in which a company is permitted or required for accounting purposes to present, or disclose amounts in, consolidated financial statements of an ultimate parent of a group and its subsidiaries.
 - (3) “Change in accounting standards” means the issue, revocation, amendment or recognition of, or withdrawal of recognition from, an accounting standard by an accounting body.
 - (4) Regulations under this section may make provision subject to an election or other specified circumstances.
 - (5) Regulations under this section may apply to a pre-commencement period if they make provision in relation to a relevant accounting change which may or must be adopted, for accounting purposes, for

a period of account, or part of a period of account, which coincides with that pre-commencement period.

- (6) A statutory instrument containing regulations under this section to which subsection (7) applies may not be made unless a draft of the instrument has been laid before and approved by a resolution of the House of Commons.
- (7) This subsection applies if the regulations contain any provision which has or may have the effect of increasing any person's liability to tax.
- (8) Any other statutory instrument containing regulations under this section is subject to annulment in pursuance of a resolution of the House of Commons.
- (9) In this section—
 - “accounting body” means the International Accounting Standards Board or the Accounting Standards Board, or a successor body to either of those Boards;
 - “accounting standard” includes any statement of practice, guidance or other similar document;
 - “pre-commencement period”, in relation to regulations, means an accounting period, or part of an accounting period, which begins before the regulations are made.”

- 21 (1) The amendment made by paragraph 20 has effect in relation to any change in accounting standards made on or after the day on which this Act is passed.
- (2) The other amendments made by this Schedule have effect in relation to periods of account of the worldwide group ending on or after the day on which this Act is passed.

EXPLANATORY NOTE

TAX TREATMENT OF FINANCING COSTS AND INCOME

SUMMARY

1. This clause and Schedule amend the taxation of financing expenses and financing income – commonly called the debt cap.

DETAILS OF THE SCHEDULE

2. Paragraph 1 amends the provisions of Part 7 of the Taxation (International and other Provisions) Act 2010 (TIOPA) which sets out the debt cap rules.
3. Paragraph 2 amends section 261 TIOPA and applies the debt cap rules to groups that are worldwide groups throughout the period of account in question. This is to ensure that the debt cap rules do not apply to groups that begin or cease to be worldwide groups during a period of account.
4. Paragraph 3 makes a minor change to the definition of dormant company for the purposes of section 262.
5. Paragraph 4 amends section 276 by inserting new section 276(2A). Section 276 describes how an authorised company should be appointed to allocate the disallowance of deductions. New section 276(2A) ensures that relevant group companies that are dormant companies throughout the relevant period of account do not need to sign the appointment of an authorised company. Paragraph 6 introduces a similar rule for the appointment of an authorised company for the exemption of financing income through new section 288(2A).
6. Paragraphs 5 and 7 add an additional requirement to the existing requirements in sections 280 and 292 for statements of allocated disallowances and exemptions. The additional requirement in new section 280(5A) is that a disallowance can only be allocated against a relevant group company's financing expense if at the time that the financing expense arose the company was a relevant group company of the worldwide group. There is a similar provision in new section 292(5A) for the exemption of financing income for a UK group company. Both of these new sections ensure that financing expenses are disallowed or financing income exempted only if they arise when the company is a member of the worldwide group.

7. Paragraph 8 introduces new section 305A which is anti-avoidance legislation. New section 305A applies if a large group attempts to remove itself from the application of the debt cap rules by ensuring that the group does not have any relevant group companies in the period of account. If a group does not have any relevant group companies then it is not a worldwide group for the purposes of the debt cap. The legislation has two conditions that have to be met before Part 7 can apply to the large group. The conditions are in subsections (3) and (4) of the new section 305A. The first condition is that during a period of account the group entered into a scheme and the main purpose or one of the main purposes for entering into the scheme or being a party to the scheme is to secure that the group does not contain any relevant group companies. The second condition is that the scheme is not an excluded scheme.
8. Paragraph 9 makes a minor change to the computation of financing expense amounts under section 313. It amends section 313(6) to allow adjustments to be made to financing expenses on a just and reasonable basis where part of the accounting period of the company falls outside the period of account of the worldwide group. It also introduces new section 313(6A) which allows for the amount of financing expenses to be reduced to nil. Paragraph 10 similarly amends section 314 (6) and introduces new section 314(6A) for financing income.
9. Paragraph 11 removes section 316(4) which provided that if there was more than one group treasury company in a worldwide group then each of the group treasury companies had to make an election under section 316 for their financing expenses and financing income to be disregarded for the debt cap.
10. Paragraphs 12 and 13 amend sections 329(3) and 330(3) by removing the reference to a transaction so it is clear that amounts that might not be thought of as transactions, such as interest, are included in any apportionment necessary because the company was not a relevant group or UK group company. They also insert new sections 329(6) and 330(6). These allow an election to override the de-minimis rules in sections 329(5) and 330(5).
11. Paragraph 14 inserts new section 331ZA into Part 7. This section enables worldwide groups to elect out of the de-minimis rule for net financing deductions and net financing income of group companies. The election is made by the reporting body of the worldwide group and will apply to both net financing deductions and net financing income. The election requires the reporting body to provide certain information when making the election such as the first period of account to which it applies, details of the UK group companies at the time the election is made and of any UK group companies that have

left the group between the beginning of the first period of account subject to the election and the date that the election is made.

12. New sections 331ZA(3) – (5) specify that the election has effect until it is withdrawn or replaced by a further election. The withdrawal of the election must be made by the reporting body of the worldwide group and must specify from when the election is withdrawn. If the reporting body of the worldwide group is the UK group companies acting jointly then dormant companies are not included in the reporting body.
13. New section 331ZA(6) requires that an election or withdrawal must be made in writing and be received by HMRC within 12 months of the end of the first period of account to which the election applies or for which the election is withdrawn. New section 331ZA(7) requires that the notice of election or withdrawal should be signed by the appropriate person. New section 331ZA(8) provides the definitions of “appropriate person”, “relevant time” and “specified period of account”.
14. Paragraph 15 inserts new section 337(2) into the definition of worldwide group. This is to ensure that the definitions of relevant group company in section 345 and worldwide group in sections 337 are not self referential.
15. Paragraph 16 clarifies the definition of ultimate parent in section 339 to prevent foreign partnerships that would be collective investment schemes if they were formed under UK law from being the ultimate parent of a worldwide group.
16. Paragraph 17 introduces new section 348A which deals with how the debt cap rules apply to a worldwide group before and after a business combination or de-merger. New section 348A(1) has three conditions. The first is that a worldwide group is a party to a business combination or de-merger, the relevant event. The second is that as a result of the relevant event there is a change in the ultimate parent of the worldwide group or any other group that is party to the relevant event. The final condition is that financial statements of the worldwide group are drawn up (or would be treated as drawn up but for section 348A) for a period of account during which the relevant event occurs – the straddling period.
17. If these three conditions are met then new section 348A(2) applies Part 7 as if no financial statements had been drawn up by the worldwide group for the straddling period and section 348 does not apply to require the worldwide group to draw up financial statements for that period. Instead Part 7 applies as if financial statements had been drawn up in respect of a period of account beginning at the same time as the straddling period and ending the day before the relevant

event and a second period of account beginning on the day of the relevant event and ending at the same time as the straddling period. In effect any worldwide group involved in the relevant event is required to finalise its debt cap computation for the period before the relevant event and begin a new debt cap computation from the date of that event.

18. New section 348A(3) defines “de-merger” and applies the section 348(5) definition of IAS financial statements to new section 348A.
19. Paragraph 18 includes “business combination” in the list of expressions taking their meaning from international accounting standards in section 351.
20. Paragraph 19 includes “dormant company” in the list of other expressions in section 353. A dormant company is a company that is dormant by virtue of section 1169 of the Companies Act 2006 and which is not subject to transfer pricing adjustments arising under section 147. The definition also includes non-resident companies that are dormant under legislation equivalent to section 1169 of the Companies Act 2006.
21. Paragraph 20 introduces a power to make regulations where a change in accounting standards effects how the ultimate parent of a group presents or discloses amounts in its consolidated financial statements. The power is to enable regulations to be made particularly in response to expected changes to International Financial Reporting Standards 10, 11 and 12.
22. New section 353AA allows the regulations to amend Part 7 if there is a relevant accounting change. A relevant accounting change is a change in the way that a company is required or permitted to present or disclose amounts in its consolidated accounts. A change in accounting standards includes the issue, revocation, amendment, recognition or withdrawal of recognition of accounting standards by an accounting body. The regulations may include an election. New section 353AA(5) allows the regulations to apply to a pre-commencement period which is defined as an accounting period or part of an accounting period that begins before the regulations are made. This will enable the regulations to apply to early adopters of the changes in accounting standards if necessary. The regulations will be made under the draft affirmative procedure or negative procedure depending on whether or not they have the effect of increasing any person’s tax liability. New section 353AA(9) contains definitions of “accounting body”, “accounting standard” and “pre-commencement period”.
23. Paragraph 21 gives the commencement dates for the amendments. The power to make regulations where accounting standards change

has effect for any change of accounting standards on or after the date of Royal Assent. All other amendments apply to periods of account of the worldwide group ending on or after the date of Royal Assent.

BACKGROUND NOTE

24. Finance Act (FA) 2009 introduced a package of changes to the taxation of companies on their foreign profits. This package included the introduction of a measure to restrict the interest and other finance expenses that can be deducted in computing the corporation tax payable by UK members of a worldwide group of companies.
25. The debt cap rules introduced as Schedule 15 to FA 2009 have now been rewritten as Part 7 of TIOPA 2010. They broadly operate by requiring UK groups to compare their UK financing costs, as calculated under the Schedule, with the finance costs of their worldwide group. If the UK costs exceed the worldwide costs then the UK companies do not get any relief for the excess.
26. Discussions with industry have identified that some amendments to the debt cap rules would be needed. A number of changes were made in Finance (No.3) Act 2010 but further issues have since arisen.
27. The current Schedule incorporates a small number of changes that arose from consultation with groups and their representatives.
28. If you have any questions about this change, or comments on the legislation, please contact Lesley Hamilton on 020 7147 2564 (email: lesley.hamilton@hmrc.gsi.gov.uk) or Fiona Hay on 020 7147 2543 (email: fiona.hay@hmrc.gsi.gov.uk).