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CFC reform

HMT and HMRC Stakeholder
event

9 November 2009

11/9/2009



Agenda

1. Introduction and update
2. Presentation on questionnaire results
3. Emerging thinking on new regime
4. Question and answer session





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Introduction





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CFC team

HMT

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CFC reform

'There is a continuing need for CFC rules to protect the UK tax base from erosion. However, it is essential that the rules keep pace with the changing economy.....the Government considers that there is scope for modernising the CFC rules in a way that will enhance UK competitiveness while providing adequate protection of the UK tax base.'

FST open letter, 24 November 2008

No Ministerial decisions have been made yet on details of new regime. Final decisions on the implementation of any revised CFC rules will need to take into account the economic position and wider Government finances





Purpose of this event

- General update to business on the progress of the CFC reform throughout 2009, and
- Discuss and share the main results from the questionnaire responses
- HMT/HMRC developing policy with a view to addressing as many of the points raised in the questionnaire as possible, but can not promise that all this can be delivered given the fiscal constraints and need to protect the UK tax base





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Update





Work to date and milestones

- Stakeholder engagement strategy document (June 09)
- Policy principles document (July 09)
- Questionnaire (Autumn 09)
- Working groups (Autumn 09)
- Document for discussion (around the end of 2009)
- Aiming to implement in FB 2011

Ongoing dialogue with liaison committee





Policy principles document – Key points

Principles

- Move towards a more territorial approach while retaining ownership as the underlying principle, and refocusing on artificial diversion from UK
- Moving away from presumption that all activities that could have been done in the UK would have been carried on here, had it not been for tax advantage in overseas location

Objectives

- Enhance UK competitiveness to reach an outcome that is better for business, while providing adequate protection of the UK tax base.
Improve the way that the regime targets artificial diversion of profits from the UK
- Recognises the way modern business operates; Simplicity; Certainty; Not intended to increase the scope of the rules; EU compliant





Working groups

- Working groups held on Intellectual property and monetary assets
- 24 representatives from business
- Discuss issues and options
- Assist with the development of policy
- Input into discussion document





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Questionnaire results





Purpose of questionnaire

- Provided an opportunity for all interested parties to participate and share their views
- Engagement with a wide range of stakeholders
- Early on in process to ensure views can be considered throughout
- Balance responses with other stakeholder engagement ie meetings with individual businesses, working groups and liaison committee
- Where possible, constraints allowing, HMT/ HMRC will seek to respond to business priorities and considerations for new regime





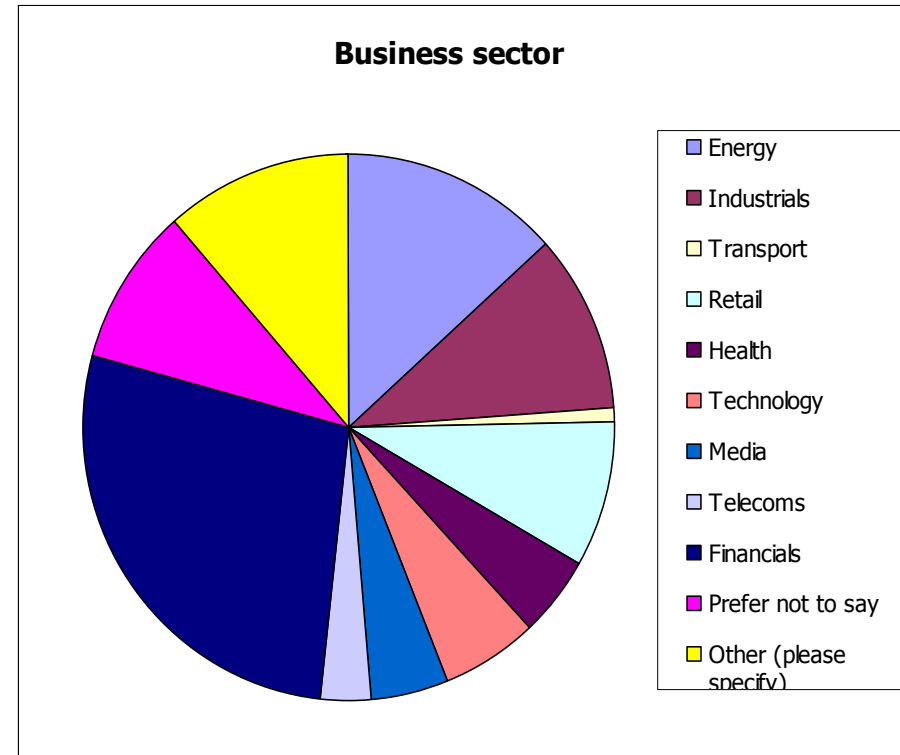
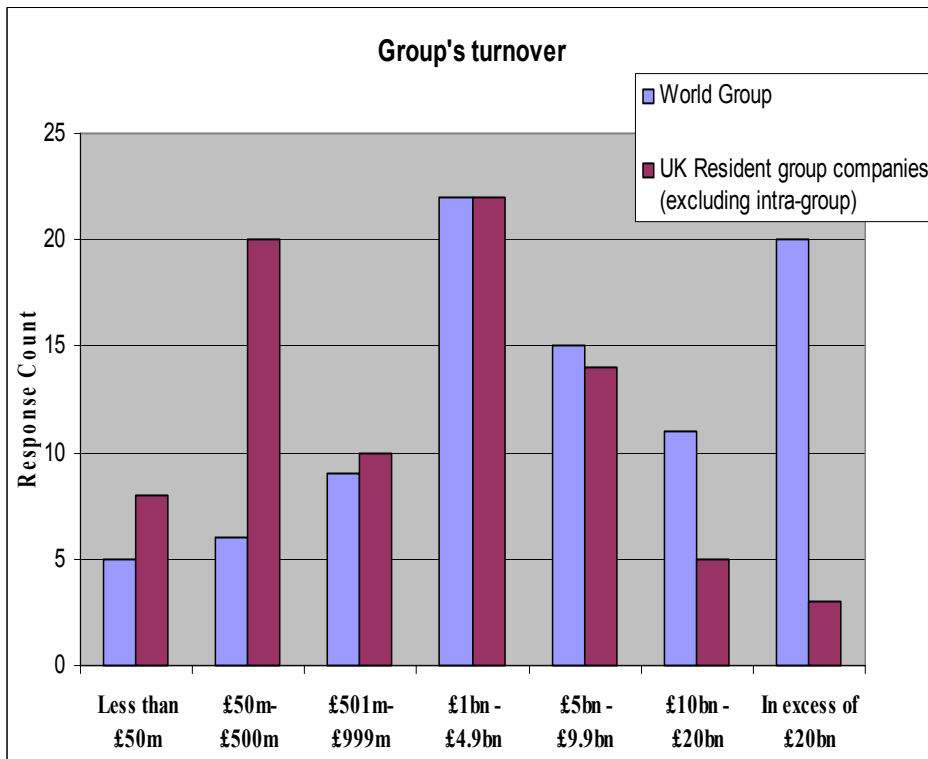
Respondents

- Over 70 in total
- 59 taxpayers
- 15 other interested parties – mainly tax advisors
- Cross section of industry groups and business sizes





Respondents





Workings of current UK CFC regime

Aspects of current regime respondents found of most concern to business (ranked in order of frequency)

1. Exempt activities test
2. Motive test
3. Administration burden
4. Complexity and uncertainty
5. Lower level of tax test

Taxpayer Q14, other Q5





Workings of current UK CFC regime: Migration from the UK and inward investment

- Many UK based respondents noted they had undertaken a review to consider the implications of migrating out of the UK
- The single most important factor in the decision was the scope and application of the CFC rules along with continued uncertainty over the direction of the reform and ongoing litigation
- Those groups that were considering inward investment into the UK considered that the current CFC rules can hinder investment due to instability of the rules, uncertainty of direction and complexity. However non-tax commercial drivers always override any tax considerations





Considerations for new regime: Behaviours

The majority of respondents considered a new regime should target 'artificial arrangements' intended to avoid UK tax

Respondents noted characteristics of 'artificial arrangements' could include:

- Those with no commercial purpose
- Abusive transactions
- Those with no economic substance
- UK groups placing passive income outside the UK
- Main purpose or one of the main purposes to avoid UK tax
- Direct stripping of the UK tax base
- Movement of profits from the UK without moving the substance

Taxpayer Q18, other Q8

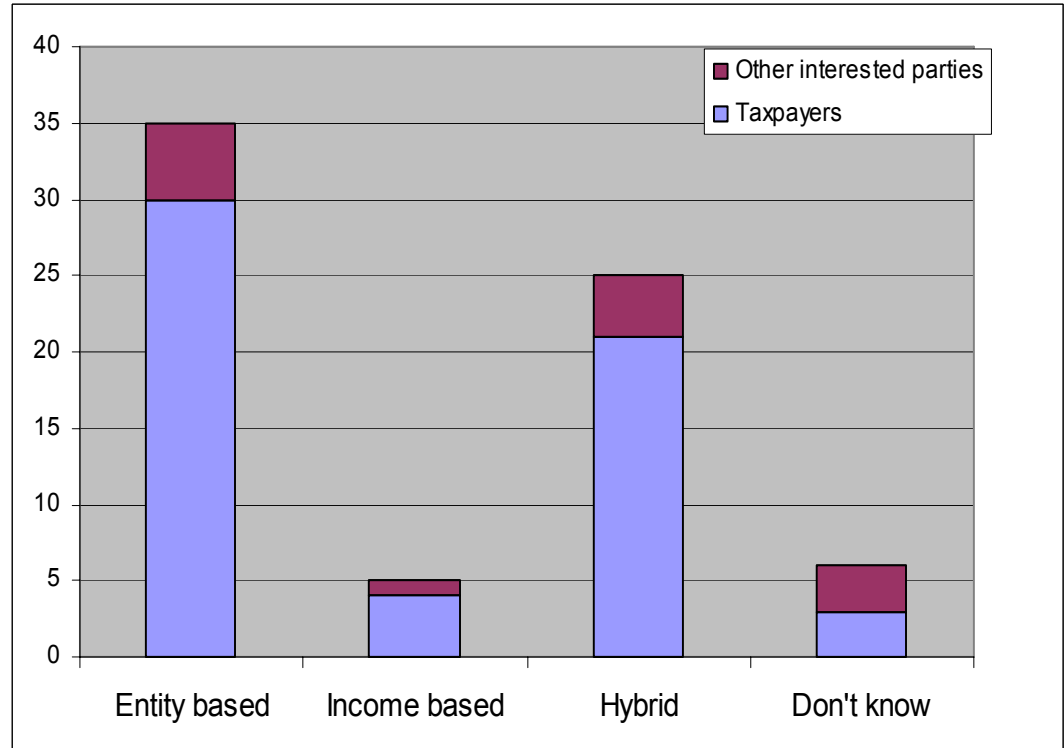




Considerations for new regime: Basis

Fifty percent of respondents considered the new regime should work on an entity basis as it was considered to be simple, familiar and would lead to the lowest compliance burden

Thirty five percent of respondents considered a hybrid approach would enable closest targeting and offer sufficient flexibility to reach the 'right' result



Taxpayer Q23, Other Q13





Considerations for a new regime: Business purpose test

- Vast majority of respondents considered an overriding business purpose test is an essential or highly desirable feature of a new CFC regime
- Test should be a taxpayer obligation
- Respondents considered that the test should be to demonstrate the objective of a transaction is not to avoid UK tax but to pursue non-tax related commercial objectives





Considerations for a new regime: Separate EEA regime

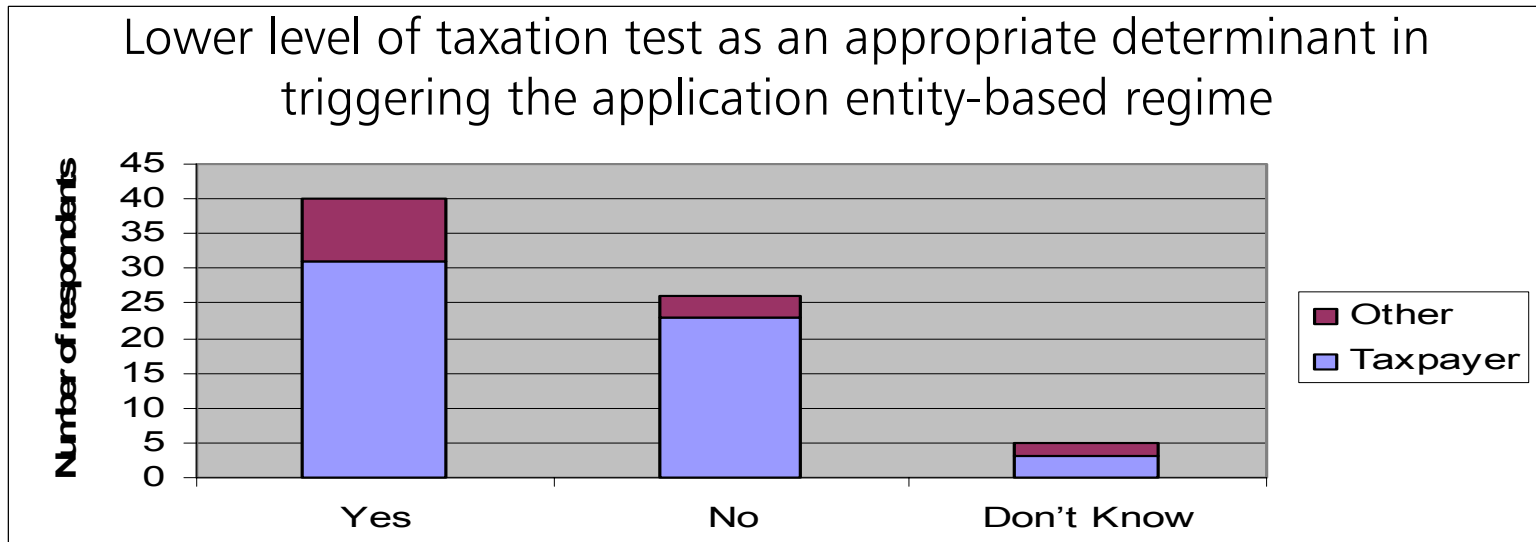
Approximately sixty percent of respondents considered that a separate regime for EU/EEA subsidiaries would prove problematic

- Main objections around complexity and compliance
- Respondents were concerned that two regimes would distort commercial decisions
- Of the respondents that considered two regimes would not be problematic many noted this would only be the case if the EU rules had a lower compliance burden/ tax cost





Considerations for a new regime: Lower level of tax test

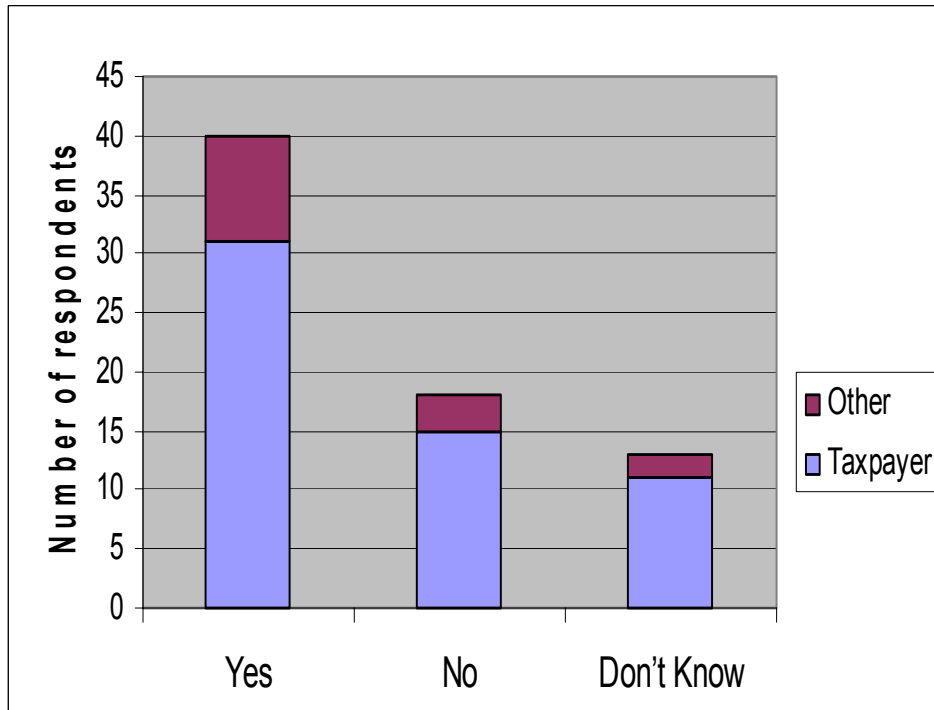


Overarching message – lower level of taxation test should be simple and easy to calculate





Considerations for a new regime: Black list preferable to lower level of tax test?



Most respondents considered that a black list would reduce the administration burden however it would depend on how it is drawn and should be subject to a genuine purpose test

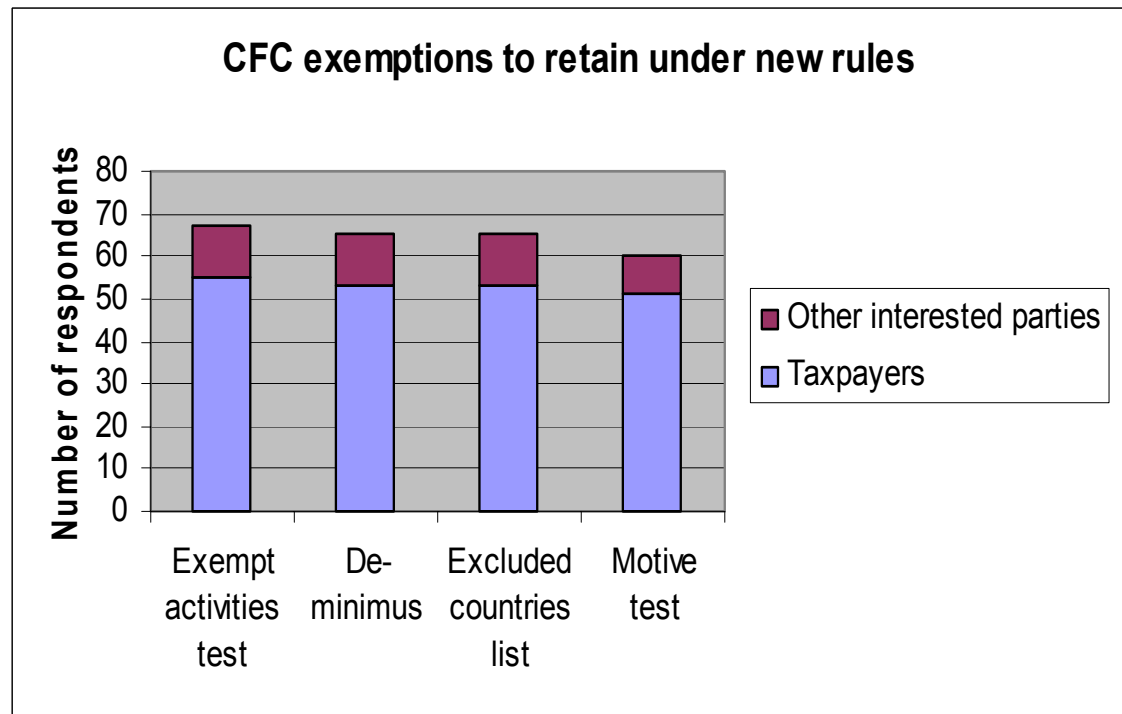




Consideration for new regime: exemptions

Respondents suggested some modifications to the current exemptions including simplification and modernisation of the exempt activities test and re-drafting of the motive test and HMRC application

Most requested the current exemptions are retained





Considerations for a new regime: additional exemptions requested by business

Respondents noted other exemptions they would like to see introduced including

- Business purpose test – a commercial realistic motive test,
- Property/ real estate exemption,
- Active IP Company,
- Treasury Company,
- EU and
- Captive insurance.





Other responses

- Some respondents continue to be of the view that CFC rules are not required
- Respondents emphasised the complexity of the current regime and compliance burden in relation to the small number of apportionments actually made
- Some respondents considered that the insurance and banking sectors should be given a special carve-out (or at least borne in mind when designing any business purpose test)
- Respondents noted that the US approach should be avoided given its complexity





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Emerging thinking





Emerging thinking on overall shape of new regime

- Entity v Income
- Balance between objective and purposive approaches

Objective approach would work by designing simple tests as proxies for artificial diversion from the UK

Purposive approach would work by having an over-riding principle that would apply to profits held in low tax jurisdictions

- Based on feedback from working groups, questionnaires and wider business consultation, preferred shape of new regime:
 - Entity rather than income basis, but moving away from an 'all or nothing' approach
 - Prefer to start with simple/certain objective tests, reducing pressure on subjective purpose based test
 - Avoid tracing rules





Emerging thinking on money and IP

- Business agree that money and IP are the key areas to resolve
- Working groups discussed issues and considered options to address artificial diversion
- Issues arising on money:
 - Treatment of group financing and treasury activities.
 - New regime should better recognise the commercial drivers for treasury and finance operations
 - While recognising the risk to UK tax base from diversion, business want flexibility to manage their global tax rate
- Issues arising on IP:
 - New regime should recognise that IP may be held offshore as an active part of business, not only as a passive investment
 - A major risk to UK tax base can arise on transfer of IP from UK





Next steps

- Publication of document on shape of new regime around end of 2009
- Detailed consultation on the document following publication
- Continued open and constructive consultation with business to ensure that the new regime will be more competitive for business, while proving adequate protection of UK tax base





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Question and Answer session

