



HM TREASURY



HM Revenue  
& Customs

# Reform of Controlled Foreign Companies (CFC)

HMT and HMRC Stakeholder  
event

23 February 2010

2/24/2010



# Agenda

1. Introduction and outline of timetable
2. Policy principles
3. Framework
4. Monetary assets
5. Intellectual property
6. Next steps





## Introduction

- CFC review forms the second part of foreign profits reform
- HMT and HMRC are grateful for the input received from business to date (including liaison committee members, working groups and individual businesses and their representatives)
- Document published in January is a **discussion document** with a number of proposals for reform.
- HMT and HMRC encourage discussion and welcome thoughts on the document and questions posed.





## Timetable for reform

- Consultation on discussion document (until 20 April 2010 )
  - Meeting with industry representatives, individual businesses and advisors
  - Stakeholder events
  - Receive written responses
- More detailed proposals and draft legislation (later in 2010)
- Legislation (FB 2011)





## Policy principles

- Enhance competitiveness of UK whilst providing adequate protection of UK tax base
- Target artificial diversion of profit from UK
- Move to a more territorial approach
- Minimise compliance costs and provide taxpayers with certainty
- Compliant with EU law





## Overarching framework

- Entity basis with hybrid elements where these contribute to a more proportionate regime
- Alternatives discounted:
  - income streaming
  - single purpose test approach





## Scope of regime: Lower level of tax test/ Excluded countries

- Rules will apply to situations where there is a risk of artificial diversion of UK profits to low tax jurisdictions
- HMT/ HMRC investigating whether an alternative to lower level of tax and white list could be used
- Considering a test to exempt companies in territories that have:
  - similar statutory rate to UK
  - similar tax base to UK





## Scope of regime: Exempt activity test

- Objective test to remove the majority of overseas subsidiaries from the regime where undertaking genuine trading activities
- Intra group transactions: move from current position; exempt where no risk to UK tax base
- Specific examples to consider for exemption (where appropriately funded)
  - reinsurance of non UK risks
  - management of non-UK properties





## Scope of regime: De-minimis

- Current limit set in 1998, case for uprating
- Considering a range of options posed by questionnaire respondents
- One possibility is to have different limits for small and medium enterprises (SMEs) and large businesses.





## Scope of regime: Motive test

### New motive test

- Apply new motive test if none of other exemptions relevant
- move away from default assumption that activities that could be carried out in UK should be
- instead test that company is engaged in commercial activities that are not intended to artificially divert UK profit

Also consider including some flexibility tailored to each of the other exemptions where objective criteria are narrowly missed.





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Monetary assets: Allow groups to manage monetary assets in a way that best supports overall competitiveness while providing appropriate protection of the UK tax base





## Monetary assets: Principles

- 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
- UK funds include
  - UK borrowings
  - accumulated UK funds





## Monetary assets: Treasury operations

- Distinction between treasury and finance operations
- Exemption for treasury operation companies
- Consult on substance and scope of exemption





## Monetary assets: Finance companies

- Exemption for finance companies in low tax jurisdictions where company appropriately funded by reference to mix of debt:equity
- Options include safe harbour ratio or reference to debt:equity of group
- Consult on appropriate level of funding





## Monetary assets: Excess cash

- Balanced package for monetary assets
- Non-trading income earned by a trading company in a 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 or ancillary test





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Intellectual property: 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 the UK
- Characteristics based test focus on expertise
- 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 that is not actively managed (passive)

- 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





## Next steps

- HMT/ HMRC to discuss proposals with businesses, representative bodies and advisers during consultation period
- Receive and review written responses
- Work up more detailed proposals post consultation, consider further working groups
- Publish more detailed proposals and draft legislation later in 2010, aim to legislate in FB 2011.

