

FINANCE ACT 2015

EXPLANATORY NOTES

INTRODUCTION

Section 110: “the Insufficient Economic Substance Condition”

Summary

1. This section sets out the conditions under which the insufficient economic substance condition, which is required to be met for section 80 or for subsection (2) of section 86, is met.

Details of the Section

2. Subsection (2) sets out the meaning of “the first party” and “the second party” For the purposes of section 80 these are, respectively, the UK-resident company (“C”) and another person (“P”). For the purposes of section 86 these are, respectively, the foreign company and another person (“A”).
3. Subsection (3) provides that the “insufficient economic substance condition” is met where one of more of subsections (4) to (6) apply.
4. Subsections (4) and (5) apply where the material provision that gives the effective tax mismatch outcome is made or imposed by means of a single transaction or a series of transactions. It requires a comparison of the financial benefit of the tax reduction with any other financial benefit referable to the transaction or transactions, for the first and second parties taken together. The “tax reduction” has the meaning given by subsection (4) of section 107. It must also be reasonable to assume that the transaction was designed to secure the tax reduction, subject to the clarification provided at subsection (9).
5. Subsection (6) applies where a person that is party to a transaction or to one or more transactions in a series, to which subsection (b) of section 80 or subsection (2)(a) of section 86 refers, and it is reasonable to assume that the person’s involvement in the transaction or transactions was designed to secure the tax reduction, unless one or both of the conditions in subsection (7) is met.
6. Subsection (7) sets out the conditions referred to in subsection (6). These test the person’s contribution of economic value to the transaction or series of transactions by reference to the functions or activities that its staff perform and compare this to the value of the financial benefit of the tax reduction.
7. Subsection (8) sets out who is included in a person’s staff for the purposes of subsection (7).
8. Subsection (9) describes the circumstances to which regard must be had when determining that a transaction or transactions are designed to secure a tax reduction and makes clear that a transaction or transactions may be designed to secure that end even though they may also have been designed to secure other ends.

*These notes refer to the Finance Act 2015 (c.11)
which received Royal Assent on 26 March 2015*

9. Subsection (10) sets out the meaning of other defined terms used in the section.

Background Note

10. The diverted profits tax is a new charge on diverted profits. The main objective is to counteract contrived arrangements used by large groups (typically multinational enterprises) that result in the erosion of the UK tax base.