

**EXPLANATORY MEMORANDUM TO THE  
THE EXEMPTION FROM TAX FOR CERTAIN INTEREST PAYMENTS  
REGULATIONS 2004**

**2004 No. 2622**

1. This explanatory memorandum is laid before The House of Commons by Command of Her Majesty. It contains information for the Select Committee on Statutory Instruments. The Department responsible is the Inland Revenue.
2. **Description**
  - 2.1 These Regulations make provisions in relation to the issue of exemption notices by the Board of Inland Revenue permitting payments of interest to be made without deduction of tax under section 349 of the Income and Corporation Taxes Act 1988 (c. 1) pursuant to section 100 of the Finance Act 2004 (c. 12). Chapter 6 of the Finance Act implements the provisions of Council Directive 2003/49/EC of 3rd June 2003.
  - 2.2 The Directive applies to payments of interest and royalties between associated companies resident in other Member States, made after 1 January 2004 (1 May 2004 in respect of the ten States becoming Member States on that day).
3. **Legislative Background**
  - 3.1 Sections 97 – 106 Finance Act 2004 introduce an exemption from income tax for companies resident in other Member States in relation to payments of interest and royalties made by associated companies in the United Kingdom (or the United Kingdom permanent establishments or companies resident in another Member State).
  - 3.2 These Regulations 2004 set out detailed conditions whereby the exemption from income tax provided for by section 97 – 106 Finance Act 2004 is to be granted in relation to payments of interest. The Regulations are made under the power conferred by section 100(1) of the Finance Act 2004 and are subject to annulment in pursuance of a resolution of the House of Commons.
4. **Matters of Special Interest to the Select Committee on Statutory Instruments**

A draft version of these Regulations was published in December 2004, and provisions in the Finance Act 2004 give effect to the arrangements in the draft version until such time as the final Regulations come into force (see s.106 FA 2004). Other than minor stylistic changes, the one significant difference between

these Regulations and the draft version is the inclusion of an appeal right in Regulation 9.

## **5. EU Legislation**

The Exemption From Tax For Certain Interest Payments Regulations 2004 make provision in relation to the implementation of EU legislation, namely Council Directive 2003/49/EC of 3rd June 2003 (“The Interest and Royalties Directive”).

## **6. Extent**

The instrument applies to all of the United Kingdom.

## **7. Policy Background**

7.1 The Interest and Royalties Directive provides for the elimination of source state taxation on interest and royalty payments between associated companies in different Member States of the European Union. In achieving this, it overlaps significantly with what has already been achieved through bilateral Double Taxation Agreements between the UK and the other Member States. These seek to eliminate double taxation where both states claim taxing rights on the same sources of income under domestic law. The source state will generally require the payer to withhold an amount of tax from a payment.

7.2 In the case of interest and royalty payments made by a resident of one state to a resident of the other, potential double taxation is resolved in Double Taxation Agreements in one of two ways. The UK’s preferred method is to award taxing rights solely to the state of residence of the recipient. But in some cases taxing rights are shared between the states, by a reduction in the rate of withholding tax, and a credit for this tax being granted by the state of the recipient.

7.3 The Directive requires the adoption the former solution for all payments within its scope (subject to transitional arrangements for some Member States). The Regulations affect only payments of interest, and set out procedures for the granting of exemption as provided for by the Directive. Procedures for royalty payments are set out in primary legislation (s.101 FA 2004). In both cases the procedures closely mirror existing arrangements for granting the similar relief available under Double Taxation Agreements. For this reason, the procedures are familiar to users of the scheme, and these Regulations do not impose any additional burdens on business.

## **8. Impact**

A regulatory impact assessment was published in April. We will review the RIA after the rules come into effect. These Regulations do not impose any additional compliance burdens on business.

## **9. Contact**

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