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STATUTORY INSTRUMENTS

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**2005 No. 185**

**INCOME TAX**

**The Controlled Foreign Companies (Excluded Countries) (Amendment) Regulations 2005**

<i>Made</i>	- - - -	<i>1st February 2005</i>
<i>Laid before the House of Commons</i>	- - - -	<i>2nd February 2005</i>
<i>Coming into force</i>	- -	<i>31st March 2005</i>

The Commissioners of Inland Revenue, in exercise of the powers conferred on them by section 748(1)(e) and (1A) of the Income and Corporation Taxes Act 1988(1), make the following Regulations:

**Citation, commencement and effect**

1.—(1) These Regulations may be cited as the Controlled Foreign Companies (Excluded Countries) (Amendment) Regulations 2005 and shall come into force on 31st March 2005.

(2) These Regulations have effect in relation to accounting periods of companies resident outside the United Kingdom beginning on or after 3rd December 2004 (in connection with which see regulation 6 below).

**Amendment of the Controlled Foreign Companies (Excluded Countries) Regulations 1998**

2. The Controlled Foreign Companies (Excluded Countries) Regulations 1998(2) are amended as follows.

**Amendment of regulation 2**

3. In regulation 2(2)(b) (interpretation: alternative residence test for controlled foreign companies) for “incorporated in that territory;” substitute—

“incorporated in that territory and liable to tax in that territory on its profits;”.

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(1) 1988 c. 1. Section 748 was amended, and subsection (1A) inserted, by paragraph 3 of Schedule 17 to the Finance Act 1998 (c. 36).  
(2) S.I. 1998/3081. There are amendments which are not relevant for present purposes.

## Amendment of regulation 5

- 4.—(1) Amend regulation 5 (income and gains requirement) as follows.
- (2) In paragraph (2) for “but disregarding capital profits or losses” substitute—  
“subject to the qualifications in paragraphs (2A) and (2C)”.
- (3) After paragraph (2) insert—  
“(2A) In computing a controlled foreign company’s commercially quantified income capital profits and losses shall be disregarded.  
(2B) Paragraph (2C) applies if a controlled foreign company—  
(a) has invested, whether directly or indirectly, in an entity which is not a company, but is engaged in economic activity;  
(b) is capable of exercising control over the entity; and  
(c) the entity receives, whether directly or indirectly, at least 50 per cent. of its commercially quantified income, computed in accordance with paragraphs (2) and (2A) above from bodies which are associated or connected with the company, the reference to paragraph (2C) in paragraph (2) being disregarded for this purpose.  
(2C) Where this paragraph applies, that part of the income and gains of the entity mentioned in paragraph (2B)(a), which bears to the whole the same proportion as the extent of control, determined in accordance with regulation 7(1A) below, bears to the whole (“the controller’s share”), shall be treated, for the purposes of these Regulations, as the income and gains of the controlled foreign company by which the entity is controlled (if not already included in that income or those gains).”.
- (4) In paragraph (3) for “paragraph (4) (special rule for banks and insurance companies)” substitute “paragraphs (3A) to (4) (special rules about connected persons and about banks and insurance companies)”.
- (5) After paragraph (3) insert—  
“(3A) Where a controlled foreign company—  
(a) has entered into one or more transactions with one or more connected or associated persons;  
(b) the value to the company of that transaction, or the aggregate value to the company of all of those transactions, exceeds fifty per cent. of the commercially quantified income of the company; and  
(c) the income and gains arising to, or the expenditure incurred by, the connected or associated person as a result of that transaction is taken into account—  
(i) in computing the company’s profits for tax purposes in the territory in which resides but not in computing its chargeable profits, or  
(ii) in computing the company’s chargeable profits, but not in computing its profits for tax purposes in the territory in which it resides;  
paragraph (3B) applies.  
(3B) If this paragraph applies—  
(a) the income and gains to which paragraph (3A)(c) applies shall be treated as non-local source income of the controlled foreign company; and  
(b) an amount equal to which paragraph (3A)(c) applies shall be treated as non-local source income (and accordingly added to the amounts produced by sub-

paragraphs (a) to (f) of paragraph (3) for the purpose of computing the amount of non-local source income).”.

#### **Amendment of regulation 7**

5.—(1) Amend regulation 7 (interpretation of regulations 5 and 6) as follows.

(2) After paragraph (1) insert—

“(1A) For the purposes of regulation 5(2B) a company (“C”) is capable of exercising control over another entity—

- (a) where C is entitled to a share of more than one half of the assets, or more than one half of the income of the entity; or
- (b) where, if the entity were a company and C were resident in the United Kingdom, C would be treated as having control of it for the purposes of Chapter 4 of Part 17 of the Taxes Act (tax avoidance: controlled foreign companies).”.

#### **Transitional provision**

6. Where an accounting period of a company resident outside the United Kingdom—

- (a) would, without amendment, have ended on or after 2nd December 2004; but
- (b) is amended on or after that date so as end before that date

an accounting period of the company shall, for the purposes of Controlled Foreign Companies (Excluded Countries) Regulations 1998, be treated as having ended on that date..

1st February 2005

*Ann Chant*  
*Helen Ghosh*  
Two of the Commissioners of Inland Revenue

*Status: This is the original version (as it was originally made). This item of legislation is currently only available in its original format.*

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## EXPLANATORY NOTE

*(This note is not part of the Regulations)*

These Regulations amend the Controlled Foreign Companies (Excluded Countries) Regulations 1988 (S.I.1998/3081 “the principal Regulations”). Section 748(1A) of the Income and Corporation Taxes Act 1988 (c. 1), in exercise of which these Regulations are made, authorises the making of retrospective provision.

Regulation 1 provides for the citation, commencement and effect of these Regulations.

Regulation 2 introduces the amendments to the principal Regulations.

Regulation 3 amends the alternative test for a company’s residence in regulation 2(2)(b) of the principal Regulations so that it must be both incorporated and liable to tax in that territory on its profits.

Regulation 4 amends regulation 5 of the principal Regulations. Paragraph (1) introduces the amendments, and paragraphs (2) and (4) make amendments consequent upon the amendments in paragraphs (3) and (5) respectively.

Paragraph (3) inserts two new paragraphs (2B) and (2C) dealing with the control by a controlled foreign company of bodies which, although not companies, are engaged in economic activity. It also make an amendment consequent on these paragraphs, which re-enacts part of paragraph (2) of regulation 5 as it stood before the amendments.

The amendment made by regulation 4(5) provide that, if at least 50% of the commercially quantified income of a controlled foreign company’s derives from transactions with connected or associated person of the company, that income shall be treated as forming part of the company’s non-local source income.

Regulation 5 amends regulation 7 of the principal Regulations to provide an explanation of the circumstances in which a company is capable of exercising control over an entity referred to in the new paragraph (2B) of regulation 5 of the principal Regulations.

Regulation 6 makes transitional provision so that should a company’s accounting period would have ended before these Regulations come into force , but is amended after they come into force so as to end after the Regulations come into force, an accounting period shall be treated as having ended on the date on which they come into force.

These Regulations do not impose new costs on business.