

EXPLANATORY MEMORANDUM TO
THE TAX TREATMENT OF FINANCING COSTS AND INCOME
(CORRECTION OF MISMATCHES: PARTNERSHIPS AND PENSIONS)
REGULATIONS 2012

2012 No. 3111

1. This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs ("HMRC") and is laid before the House of Commons by Command of Her Majesty.

This memorandum contains information for the Select Committee on Statutory Instruments.

2. **Purpose of the instruments**

- 2.1. Part 7 of the Taxation (International and Other Provisions) Act 2010 ("TIOIPA 2010") includes provisions which set a ceiling (known as the "debt cap") on the total interest and other specified financing expenses for which corporation tax deductions are available to the UK members of a worldwide group of companies that are subject to corporation tax.

- 2.2. The ceiling is calculated by reference to the difference between the financing expenses of the members of the worldwide group which are subject to corporation tax and the amount (called the "available amount") disclosed in the accounts of the worldwide group in respect of specified financing costs.

- 2.3. The purpose of these Regulations is to address two of specific cases of mismatches between financing expense amounts and the available amount in respect of the same financial arrangements.

3. **Matters of special interest to the Select Committee on Statutory Instruments**

- 3.1. Section 336A(4) of TIOIPA 2010 permits regulations under that section to have effect in relation to periods of account of the worldwide group beginning on or after the beginning of the calendar year in which the regulations are made. These Regulations have effect in relation to periods of account beginning on or after 1st January 2012. However, a group may elect that the Regulations apply only for periods of account of the worldwide group beginning on or after the day on which they are made.

4. Legislative Context

- 4.1.** Part 7 of TIOPA 2010 was one of several measures introduced as part of the Government's review of the taxation of the foreign profits of companies.
- 4.2.** Section 332(1) of TIOPA 2010 describes those matters in respect of which amounts disclosed in the accounts of the worldwide group are included in the 'available amount'.
- 4.3.** The debt cap provisions set a ceiling on interest and other financing expenses for which corporation tax deductions are available to the UK members of a worldwide group of companies that are subject to corporation tax.
- 4.4.** These Regulations 2012 insert new sections 332D and 332E into TIOPA 2010 in relation to loans from a partnership, finance leasing and debt factoring. The Regulations also amend the Tax Treatment of Financing Costs and Income (Correction of Mismatches) Regulations 2010 (SI2010/3025) to correct a mismatch for acceptable structured finance arrangements.

5. Territorial Extent and Application

- 5.1.** This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

- 6.1.** The Commissioners for Her Majesty's Revenue and Customs have made the following statement regarding Human Rights:

In our view the provisions of The Tax Treatment of Financing Costs and Income (Partnership Mismatches) Regulations 2012 are compatible with the Convention rights.

7. Policy background

What is being done and why

- 7.1.** The policy underlying the debt cap is to restrict the deductions that the members of a worldwide group of companies which are subject to corporation tax (that is, the UK companies and those non-UK companies carrying on a trade in the UK through permanent establishments) are permitted to make for financing expenses incurred in transactions between members of the group. This is done by disallowing a deduction for the financing expenses of the companies which are subject to corporation tax, to the extent that the total of their net financing expenses exceeds the financing costs disclosed in the consolidated accounts of the group as a whole. Where a deduction is disallowed for an amount of financing expenses, a corresponding amount of

financing income may be exempt from corporation tax. The worldwide group is required to allocate disallowances and exemptions among members of the group.

- 7.2. These Regulations alter the way in which the available amount is calculated in specified circumstances where an amount disclosed, if any, in the consolidated accounts of the worldwide group in respect of a financing cost is not equal to the financing expense amount brought into account for corporation tax purposes. The Regulations thereby target the disallowance of deductions more closely on excessive financing expenses incurred in transactions between group members.
- 7.3. The Regulations address circumstances where a relevant group company borrows from a partnership in which it or connected members of a worldwide group are partners within the partnership and provides for the available amount to be adjusted in such circumstances. A similar provision is made for finance leasing and debt factoring.
- 7.4. The Regulations also addresses circumstances where a relevant group company incurs finance charges in relation to an arrangement involving an asset backed pension contribution, where certain conditions are met.

8. Consultation outcome

- 8.1. The Regulations were subject to a 4 week consultation in autumn 2012. The consultation was short because of the limited number of interested parties and the existence of the Debt Cap Working Group who were particularly invited to comment. Two responses were received on these Regulations. The responses raised questions on the extension of the Regulations to unacceptable structured finance arrangements and the interaction of the regulations with The Tax Treatment of Financing Costs and Income (Available Amount) Regulations 2010. Further analysis of the consultation responses will be on the HMRC website at the time that the instrument is laid before Parliament.

9. Guidance

- 9.1. HMRC will publish guidance on the operation of the Regulations within its Corporate Finance Manual on its website in due course. (www.hmrc.gov.uk).

10. Impact

- 10.1. The impact on business, charities or voluntary bodies is negligible.
- 10.2. The instrument has no impact on the public sector.

10.3. A Tax Information and Impact Note has not been prepared for this Instrument as it contains no substantive changes to tax policy.

11. Regulating small business

11.1. The Regulations will not apply to small business.

12. Monitoring & review

12.1. HMRC intends to monitor the legislation for further instances of mismatches and make further regulations if necessary. HMRC will review the Regulations in 2014 to determine whether they operate as intended.

13. Contact

Fiona Hay at HM Revenue and Customs (Tel: 020 7147 2543 or email: fiona.hay@hmrc.gsi.gov.uk) can answer any queries regarding the instrument.