EXPLANATORY MEMORANDUM TO

THE CORPORATE INTEREST RESTRICTION (CONSEQUENTIAL AMENDMENTS) REGULATIONS 2017

2017 No. 1227

1. Introduction

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

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

2. Purpose of the instrument

2.1 These amending Regulations provide for consequential amendments as a result of the new Corporate Interest Restriction (CIR) rules introduced in the Finance (No.2) Act 2017 (F(No.2)A 2017) which added a new Part 10 of the Taxation (International and Other Provisions) Act 2010 (TIOPA 2010).

2.2 In particular, they make amendments to:

- the Authorised Investment Funds (Tax) Regulations 2006 (S.I. 2006 / 964)
- the Taxation of Securitisation Companies Regulations 2006 (S.I. 2006 / 3296)
- the Taxation of Insurance Securitisation Companies Regulations 2007 (S.I. 2007 / 3402)
- the Investment Trusts (Dividends) (Optional Treatment as Interest Distributions) Regulations 2009 (S.I. 2009 / 2034)

2.3 The amending Regulations make provision for collective investment vehicles and securitisation companies to ensure the operation of the CIR rules does not give an unintended result in these entities.

3. Matters of special interest to Parliament

Matters of special interest to the Select Committee on Statutory Instruments

3.1 These amending Regulations have effect in relation to periods of account beginning on or after 1 April 2017 to match the commencement of the CIR rules. This will ensure the CIR rules will operate as intended from the start.

3.2 Authority for the limited retrospective effect of these amending Regulations can be found at paragraph 35 of Schedule 5 to the F(No.2)A 2017.

Other matters of interest to the House of Commons

3.3 As this instrument is subject to the negative resolution procedure and has not been prayed against, consideration as to whether there are other matters of interest to the House of Commons does not arise at this stage.

4. Legislative Context

4.1 The CIR rules follow OECD recommendations on how to tackle Base Erosion and Profit Shifting (BEPS). They will help to counter aggressive tax planning whereby multinationals arrange their interest expenses to minimise UK taxable profits.

4.2 They work by capping the amount of relief for interest expense and other financing costs (referred to as 'tax-interest' amounts) to 30% of UK taxable earnings before interest, depreciation and amortisation (referred to as 'tax-EBITDA'). Higher relief is available for commercially highly leveraged groups (the Group Ratio Rule) and special rules apply for public infrastructure companies.

4.3 These amending Regulations are needed to make certain consequential amendments to existing statutory instruments relating to collective investment vehicles and securitisation companies. Without these amending Regulations, the operation of the CIR rules would give an unintended result in these entities.

5. Extent and Territorial Application

5.1 The extent of this instrument is the United Kingdom.

5.2 The territorial application of this instrument is the United Kingdom.

6. European Convention on Human Rights

6.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

What is being done and why

7.1 Collective investment vehicles enable a number of investors to pool their assets and invest in a wider portfolio of investments. Existing tax rules deem distributions of interest type income made by Authorised Investment Funds (AIFs), Property Authorised Investment Funds (PAIFs), Tax Elected Funds (TEFs) and Investment Trusts as a payment of interest, rather than a dividend, to the investors.

7.2 However, such interest distributions are not payments of interest on a debt and so the amending Regulations exclude these amounts from the definition of 'tax-interest expense amount' for the CIR rules. This ensures the CIR rules are aligned with the tax treatment of collective investment vehicles.

7.3 Securitisation arrangements involve, in broad terms, converting an income producing asset into marketable securities via a special purpose company. It is essentially a method of raising debt finance using the income producing asset as collateral for the external debt that is issued. Special rules tax the securitisation company on the 'retained profit' provided by the capital market arrangement to reflect the underlying economic reality of the company functioning as a conduit.

7.4 The amending Regulations provide that where a company is taxed under the Taxation of Securitisation Companies Regulations 2006:

- The 'retained profit' figure is treated as the net 'tax-interest income amount' for the CIR rules (subject to it not paying certain management fees, as covered below).

- Where the securitisation company pays any fees to another UK group company for managing the securitised assets, an adjustment must be made to ensure the fee is treated symmetrically across the group. So in particular, the new regulation 22 adds the amount of these fees to the 'retained profit' figure in calculating the net tax-interest income for the period (in effect removing the fee from the amount of tax-interest income) and instead treats this amount as a negative amount of adjusted corporation tax earnings for the period.

7.5 It should be noted that no other amount can therefore be included as either an amount of tax-interest income/expense or an amount of adjusted corporation tax earnings for the period. As a result, where a securitisation company is taxed under the Taxation of Securitisation Companies Regulations 2006, it should have a positive net amount of tax-interest income under the CIR rules and will not therefore be subject to a restriction itself under the CIR rules. However, the designation of the amounts is important in determining the treatment of other group companies where the securitisation company is part of a worldwide group under the CIR rules.

7.6 The amending Regulations further provide that where a company is taxed under either the Taxation of Securitisation Companies Regulations 2006 or the Taxation of Insurance Securitisation Companies Regulations 2007 that no 'downward adjustment' is required to the 'qualifying net group-interest expense' figure where any interest paid or other distribution made by a securitisation company relates to a results-dependent security issued by an entity. This ensures the Group Ratio Rule within the CIR rules works as intended for groups which include securitisation companies.

Consolidation

7.7 The Government does not, at present, intend to consolidate the Regulations amended by this instrument.

8. Consultation outcome

8.1 The consultation ran for eight weeks ending 18 April 2017 with draft Regulations and a draft Explanatory Memorandum published on GOV.UK. Responses were generally supportive and have not required significant changes to the drafting.

9. Guidance

9.1 HMRC guidance in the Corporate Finance Manual will be amended.

10. Impact

10.1 The amending Regulations are expected to have a negligible impact overall and no impact on charities or voluntary bodies is anticipated. The overall CIR measure will have an impact on large business and more information on this can be found at paragraph 10.3.

10.2 There is negligible impact on the public sector.

10.3 A Tax Information and Impact Note (TIIN) for the overall CIR rules was published on 5 December 2016 and is available on the HMRC website at: https://www.gov.uk/government/publications/corporation-tax-tax-deductibility-of-corporate-interest-expense/corporation-tax-tax-deductibility-of-corporate-interest-expense.

It remains an accurate summary of the impacts that apply to this amendment.

11. Regulating small business

11.1 The legislation does not apply to activities undertaken by small businesses because the CIR rules do not apply to groups with less than £2 million of net interest expense per annum.

12. Monitoring & review

12.1 The policy will be monitored through information obtained through collaborative engagement with customers and enquiries into self-assessments.

13. Contact

13.1 Oli Jones at HMRC Telephone: 03000 541970 or email: oli.jones@hmrc.gsi.gov.uk can answer any queries regarding the instrument.