Controlled Foreign Companies

BUSINESS TAX GUIDE

October 2015

OVERVIEW

The UK's Controlled Foreign Companies ('CFC') rules are, in effect, anti-avoidance rules designed to counter the corporation tax consequences of a company artificially diverting its profits overseas, to a territory with a lower corporate tax rate.

Recent years have brought significant changes to the CFC regime. The aims are to better reflect modern business practice, to protect the UK tax base, and to enhance the UK's position as a preferred location for multinational businesses.

What is a CFC?

A non-resident company is subject to UK corporation tax under the UK CFC legislation if:

- it is controlled by a UK resident person or persons,
- it satisfies one of the 'Gateway Provisions' **and**
- none of the 'Entity Level Exemptions' are available.

Once a CFC is identified, a UK company holding a beneficial interest of 25% or greater in the CFC will be required to bring into account, for the purposes of UK corporation tax, its share of the CFC's profits. There are also additional disclosure requirements, but double tax relief is available on overseas tax paid.

Gateway Provisions

Profits attributable to UK activities: Its intention is to identify profits arising from arrangements which are largely tax driven, where the CFC is reliant on the UK to take on and manage its risks in a commercially effective way. The provision applies to a UK company placing assets in an overseas territory, separate to the territory in which the people employed to manage that asset are based. Essentially, this provision is looking to identify where assets have, in legal form, been transferred outside of the UK tax net but where the commercial substance is that they are still UK managed assets.

Non-trading finance profits: Finance profits such as loan interest are easy to divert to lower tax jurisdictions since little physical presence and activity is required to generate funds. The gateway only applies where the CFC's non-trading finance profits, including non-trading loan relationship profits and non-exempt distributions are more than 5% of the total profits of the trade or property business.

Trading Finance Profits: Aimed at identifying finance profits diverted from the UK, as above, the gateway applies where the CFC has trading finance profits and funds or other assets which derive from UK connected capital contributions. The capital contributions give rise to finance profits in the CFC which would not otherwise be arising had the capital been contributed at arm's length.

Captive Insurance Business: This provision applies solely to non UK resident insurance companies and brings into the CFC regime overseas profits earned from insurance services provided to a related UK company. Subject to meeting anti avoidance criteria, this provision does not apply within the EU.

Solo Consolidation: Applies only to finance companies regulated and resident in the UK which have applied to the FSA for a solo consolidation waiver. The profits which pass through the gateway are those which would not be treated as exempt under an overseas permanent establishment election if the overseas subsidiary were an overseas permanent establishment.

Entity-Level Exemptions

Having met one or more Gateway Provisions, relief from the CFC rules is achieved by meeting at least one of the below Entity Level Exemptions.

Excluded Territories Exemption: An often utilised exemption, an excluded territory is one whose (i) ***headline*** corporation tax rate is at least 75% of the UK main corporation tax rate, **and** (ii) the total of the potential CFC's relevant income does not exceed the greater of, 10% of annual profits and £50,000 (relevant income being tax exempt or subject to a reduced rate of tax), **and** (iii) none of the activities involve Intellectual Property.

Subject to conditions, Australia, Canada, France, Germany, Japan & the USA will always be deemed excluded territories.

Low Profits Exemption: Another often utilised exemption, its conditions are met if the potential CFC's annual profits do not exceed £500,000. This is reduced to £50,000 where profits are derived from non-trading income. Anti-avoidance provisions are in place to prevent the artificial manipulation of profits.

Exempt Period Exemption: This provides relief for an initial 12 month period immediately following the acquisition of a company that would otherwise be a CFC. This exemption is to enable restructuring to take place and HMRC do have discretion to extend this initial 12 month period.

Low Profit Margin Exemption: This is available to companies whose operating profit margin does not exceed 10% of operating expenditure. Interest and related party transactions are excluded from the calculation.

Tax Exemption: This applies where the actual tax rate applied to a non UK company equals at least 75% of the UK tax rate. The tax exemption is of particular assistance to a larger overseas entity as it is unlikely to fall within the excluded territories exemption.

Losses

It is not possible to bring forward any losses for periods prior to 1 January 2013, against CFC profits arising after this date. However, subject to certain criteria, relief may be given for losses incurred after 1 January 2013.

How can Rawlinson & Hunter help?

Many companies may not be aware of the current CFC regime and how it affects them. With timely professional advice and careful planning, overseas operations can be setup and operated taking full account of taxation considerations, maximising opportunities for mitigation whilst avoiding the penalty regime applicable in cases of non-compliance.

If you are interested in further information in this regard, please contact the Rawlinson & Hunter partner who normally acts for you. Where you are not one of our regular clients, please contact Craig Davies or Andrew Shilling, who would be delighted to discuss this with you in more detail.

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