
European Tax Newsalert

A Washington National Tax Services (WNTS)
Publication

United Kingdom

March 9, 2012

UK government publishes additional draft CFC legislation

On February 29, 2012, the UK government published an update and draft legislation as part of UK controlled foreign corporation ("CFC") reform. The documents provide additional proposals to simplify the gateway test and extend the application of the finance company exemption. These proposals are in addition to the draft legislation published on December 6, 2011 and January 31, 2012.

Gateway test

The draft legislation published in December 2011 excludes a CFC's profits where the assets and risks that generate those profits are economically owned by or managed by significant people functions outside the United Kingdom.

The draft legislation issued on February 29th includes a new introductory chapter to the gateway test to simplify its application. This should, therefore, reduce the compliance burden. These new provisions should exclude trading profits from CFC apportionment where one of the following conditions is satisfied:

- Condition A: the CFC does not have any assets or risks that are managed in the United Kingdom;
- Condition B: the CFC's business would remain commercially effective if the assets and risks that are managed in the United Kingdom ceased being managed in the United Kingdom;
- Condition C: the CFC does not hold assets or risks under an arrangement where the main purpose, or one of the main purposes, is to obtain a reduction in UK tax for any person, and, as a consequence of the arrangement, the CFC expects to be more profitable than it would otherwise have been; or
- Condition D: the profits are not non-trading finance profits or profits from a property business.

Hopefully this gateway test addition will further ensure that the UK CFC rules only apply to profits that have been artificially diverted from the United Kingdom. Furthermore, this change should reduce the compliance burden for many groups.

Finance company exemption

The draft legislation published in December 2011 and January 2012 included a partial and full exemption for CFC finance profits. The draft legislation published in February extended the full exemption.

CFC finance profits should now be fully exempt where the funds lent by the CFC arose from any issue of ordinary non-redeemable shares by the parent company.

Next steps

We expect an additional Finance Bill (to be issued on March 29, 2012) to include changes to the temporary period exemption and certain other aspects of the CFC rules.

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