

**HMRC Consultation on
Taxation of companies' foreign profits**

**Comments from the City of London Law Society Revenue Law Sub-Committee
("CLLS")**

**TAXATION OF COMPANIES' FOREIGN PROFITS:
DISCUSSION DOCUMENT**

We are grateful for the opportunity to comment on HMRC's discussion document on Taxation of companies' foreign profits published in June 2007 (the "Discussion Document").

1 General comments on the Discussion Document

1.1 We welcome the proposal for an exemption for dividends and the proposal to repeal the existing Treasury Consent regime.

1.2 We consider the competitive status of UK Plc to be of paramount importance in designing a new regime on the taxation of foreign profits in the United Kingdom, and we are not convinced that the proposed controlled companies regime will allow UK Plc to compete effectively against companies in other major jurisdictions.

1.3 Subject to that, simplification should be (and is claimed to be) a major objective. In order to achieve this, we believe that every element in the package, and the package as a whole, should be tested against that criterion.

1.4 We would appreciate some clarification on various aspects of the proposed controlled companies regime, for example:

1.4.1 the likely control tests that will be applied;

1.4.2 its application to capital gains; and

1.4.3 how it will deal with chains of companies (indirect holdings), joint ventures (particularly in the context of UK controlled companies, for example where one party to the joint venture is a UK entity, another joint venture party is an overseas entity and the underlying business is in the UK) and other types of entities – for example partnerships.

1.5 Answers to specific questions in the Discussion Document are provided in paragraph 3 below.

2 Comments on specific paragraphs of the Discussion Document

Controlled companies regime

2.1 We note that paragraph 4.22 of the discussion document contains a reference to capital gains falling within the proposed controlled companies regime. We think some clarification of the statements in that paragraph is necessary, and in doing so we would ask HMRC to bear in mind that companies buying assets now will need to consider the potential position in 2009 notwithstanding that no clear proposal has been made on this point.

2.2 Paragraph 4.28 of the Discussion Document states that that paragraph and paragraphs 4.29 and 4.30 will only apply to foreign companies. We consider that this is discriminatory on the basis of the principles outlined in the *Cadbury Schweppes* case.

2.3 **Interest Relief**

We consider that the proposal to restrict interest relief by reference to a group's external financing costs at paragraph 5.7 of the Discussion Document is out of step with the internationally accepted transfer pricing principles based on arm's length transactions and potentially conflicts with the taxing rights of other jurisdictions where a group has operations in more than one country.

3 **Responses to Questions for Consideration listed in Section 7 of the Discussion Document**

3.1 Question 7.1: Proposed Dividend Exemption

3.1.1 We support the proposals for exempting dividends from tax, and we consider that the exemption should apply to all dividends. The preservation of taxing rights over certain dividends, as noted in paragraph 3.11 and footnote 1 of the Discussion Document, does not reflect the proposition that the new regime will involve simplification.

3.1.2 However, we consider that the proposals for exempting dividends should go further. If HMRC's goal is simplification and it is confident that the proposed controlled companies regime will be robust, it should be consistent and exempt gains as well as income arising to a company that falls within the regime. That would provide simplification as it would help to end debates over the potential recharacterisation of returns of capital as dividends. Simplifying the existing substantial shareholding exemption would also be welcomed as it would result in a more competitive regime in the UK by comparison with other jurisdictions.

3.1.3 We are concerned by the proposal that smaller companies will be subject to a different regime in all cases. This is likely to cause difficulties for companies that later have to go through a transition to the larger company regime. We would suggest that smaller companies should be entitled to elect into the larger company regime.

3.1.4 We consider that the proposals for portfolio company dividends could be problematic. An exemption could preclude owners of portfolio holdings from qualifying for double taxation agreement benefits. Credit for underlying tax would only be workable in circumstances where the relevant information happened to be available to the shareholder or if a headline rate of underlying tax could be deemed to apply in respect of companies in specific jurisdictions.

3.2 Question 7.3: Proposed Controlled Companies Regime

3.2.1 We would ask HMRC to consider again whether it is necessary to have a UK to UK controlled companies regime. We consider that this would give rise to complications and, if it includes compensating adjustment arrangements, a regime that resembles the current group relief regime but which must be operated in parallel with that other regime. As an alternative, we would suggest a controlled companies regime that applies in cases where UK and non-EEA jurisdictions are involved.

- 3.2.2 We note the proposal that the controlled companies regime should apply to stakes as low as 10%. In our view this is too low as the regime could apply to companies that are not actually “controlled” and this may be considered too high a price for a dividend exemption by UK Plc. We would suggest that the controlled companies rules would work better if applied in a similar way to the current control test set out in Section 755D Income and Corporation Taxes Act 1988.
- 3.2.3 We should be grateful for an explanation of what grandfathering and/or transitional rules are to be proposed in order to bring the proposed controlled companies regime in to force.
- 3.3 Question 7.4: Measurement of Income
- We consider that computations should be made on the basis of International Accounting Standards (or accounts that comply with them) rather than simply UK GAAP. We believe that using UK GAAP would cause difficulties in various circumstances. For example, a company that accounts in US GAAP but is required to translate its accounts into UK GAAP purely for the purpose of the controlled companies regime would find the regime overcomplicated and administratively burdensome.
- 3.4 Question 7.6: Interest
- 3.4.1 We would appreciate clarification on the scope of the proposed changes to the interest relief rules; for example, will the definition of “tax advantage” follow on from the Section 709 TA 1988 definition as has been the case in other contexts?
- 3.4.2 We would welcome a clearance or ruling system if such interest relief rules are to be introduced, so that taxpayers can determine in advance whether interest deductions are to be restricted under the regime. In this connection, we would refer to the current consultation of clearances and advance agreements.
- 3.5 Question 7.7: Treasury Consents
- As we have mentioned above, we welcome the proposal to repeal the existing Treasury Consent regime. However, we do not see a need for “real time” reporting; in our view disclosure within a reasonable period (for example along the lines of the existing requirements in Section 765A TA 1988) should be sufficient.

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**THE CITY OF LONDON LAW SOCIETY
REVENUE LAW SUB-COMMITTEE**

The City of London Law Society is the local Law Society for solicitors practising in the City of London. It has a number of specialist Sub-Committees, the Revenue Law Sub-Committee being one of them. This response has been prepared and reviewed by the Revenue Law Sub-Committee as a whole.

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