



# UK Tax Developments Presentation to MIMA.

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## Foreign profits

- 12 September 2006 – Cadbury Schweppes ECJ decision (CFC rules).
- 6 December 2006 – Pre-Budget Report: promised consultation but also s751A ICTA 1988 (amendment to CFC rules).
- 12 December 2006 – Franked Investment Income Group Litigation Order (FII GLO).
- 21 June 2007 – HM Treasury Discussion document.
- 4 July 2008 Vodafone 2 High Court decision (CFC rules).
- 21 July 2008 – joint HMRC / HM Treasury open letter and technical note issued.
- 2008 – Pre-Budget Report: next steps?

# Foreign profits

- Consultation on following areas:
  - participation dividends
  - portfolio dividends
  - interest restriction
  - controlled foreign companies rules
  - Treasury consents.
- Government is seeking to reform above areas within context of broad revenue neutrality overall.

# Foreign profits

## Participation and portfolio dividends

- Participation dividends (shareholding 10% or more)
  - Ordinary shares (to be defined): dividends to be exempt
  - Preference shares: dividends to be taxable with simplified credit
  - Targeted anti-avoidance designed to prevent groups from moving UK profits overseas and then bringing them back as exempt dividends – but no link to new Controlled Company (“CC”) regime
  - No news on transitional rules / implications for overseas treasury companies.
  
- Portfolio dividends
  - Change needed due to ECJ decision in FII GLO: difference in taxation between portfolio and participation dividends held to be in breach of EC Treaty.

# Foreign profits Interest

- Government perception that UK interest deduction rules are generous: want to explore interest restrictions.
- Original discussion document proposed worldwide interest cap, limiting UK interest deductions to the total global external finance costs.
- Now considering various options.

## Foreign profits

### Controlled Foreign Company (CFC) rules: current position

- In common with many jurisdictions the UK has CFC rules.
- Entity based and complex: income of CFC treated as income of parent.
- Several exemptions
  - engaged in “exempt activities”, i.e. derives less than 50% of gross receipts
    - from connected or associated persons, or
    - from UK persons (excluding where it insures long-term business that is not investment business, or it is a member of an insurance group and insures large risks)
  - de-minimis: chargeable profits not > £50,000
  - resident in a country on a “white list”
  - motive test: reduction of tax not main purpose
  - pursues “Acceptable Distribution Policy” (ADP): pays at least 90% of chargeable profits to UK parent within 18 months of year end, taxed as foreign dividend.

## Foreign profits

### Controlled Foreign Company (CFC) rules: update

- Government consulting on new Controlled Company (CC) rules.
- Backing off original idea of moving to a wholly income-based approach for taxing CFCs.
- Will explore (at least) two options in relation to the CFC rules
  - improving the current entity based rules;
  - new Controlled Company (“CC”) Regime (to replace current CFC rules).
- Detail unclear, but would need to take account of possible interaction with dividend exemption.
- Any tightening of control definitions, or potential application to cell structures, would apply to captives as to other CFCs.

# Foreign profits

## Controlled Foreign Company (CFC) rules: update

- New CC rules may not apply
  - to embedded royalties or intellectual property which do not have a connection to activities which took place or take place in the UK; and
  - to capital gains overseas.
- Apportionment expected to be in respect of 25% ownership.
- Will apply to UK subsidiaries too, with compensating adjustments.
- Possible exemptions
  - active finance income (banking) and intra-group interest (appropriately capitalised group finance companies)
  - territorial income
  - for CCs that suffer a ‘higher level’ of tax.
- But no “white list” of acceptable countries.

## Foreign profits Treasury consents

- Government still wishes to repeal the Treasury consents regime.
- Proposal to replace with a targeted reporting regime.
- Details of information to be gathered under new targeted reporting regime will depend on outcome in respect of CFC / CC rules and dividend exemptions.

## Foreign profits Small companies

- Small = fewer than 50 employees and turnover or balance sheet does not exceed €50m. For groups the limits apply to consolidated figures.
- No changes proposed.
- No dividend exemption, but credit regime simplified.
- No CFC / CC rules for most small companies investing overseas.

## Foreign profits Implications for captives

- New CFC / CC rules may have significant effect.
- Unclear whether impact of ECJ decisions will be extended to CFCs in non-EEA countries.
- Unclear whether ADP exemption will remain.
- Possible that interest cap may affect upstream loans to UK parent.

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## Insurance technical reserves

- Old UK tax rules requiring “discounting” of general insurers’ technical reserves (s107 FA 2000) were repealed by FA 2007.
- New rules (Sch 11 FA 2007) require reserves to be no greater than an “appropriate amount”.
- Excess not tax deductible, but no self-assessment.
- UK tax rules apply to parent companies of captives that are CFCs for the chargeable profits calculation.
- Captives and their parents need to consider and understand reserving process.

# Insurance technical reserves

- Calibration of “appropriate amount” still subject to consultation, but HMRC aim to have Regulations in force for 31.12.2008 year end.
- January 2008 informal consultation contemplated 3 definitions:
  1. undiscounted best estimate plus 20%
  2. undiscounted best estimate plus a margin sufficient to provide a 75 per cent confidence level
  3. discounted best estimate plus a “market value margin” – the amount an insurer would have to pay a third party to transfer the risk.
- HMRC no longer happy with method 1. Instead considering option for an appropriately skilled person to certify that technical reserves do not exceed an appropriate amount.

# Insurance technical reserves

## Practical implications

- No self-assessment, i.e. figures in financial statements accepted for tax unless HMRC challenge.
- Directors and auditors need to consider effects for financial statements.
- Makes chargeable profits calculation more uncertain.

# Insurance technical reserves

## Practical implications

- Tax enquiry process for captives
  - HMRC enquiry into parent company requires evidence that the captive's technical reserves do not exceed the appropriate amount
  - in the event HMRC and parent cannot agree, HMRC can require the parent to commission a report at the parent's expense as to whether (and if so to what extent) the captive's technical reserves exceed the appropriate amount
  - parent may select the person to prepare the report, but HMRC can insist on alternative
  - likely to be an actuary (but need not be)
  - enquiries settled as now by agreement or at tax tribunal.

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# Premium Taxes

- Meeting premium tax obligations in the countries of risk is a significant issue.
- Up until 20 July 2008, non-UK based insurers had to appoint a UK fiscal representative for UK IPT.
- From 21 July 2008, non-UK based insurers can either appoint an agent for UK premium tax, or deal with HMRC directly.
- Agents are no longer jointly and severally liable for any tax, although penalties can be imposed for errors in returns they make.

# Claims Equalisation Reserves

- IFRS does not recognise CERs.
- UK regulatory requirement expected to disappear under Solvency II – expected 2012.
- UK tax rules rely on regulatory requirement.
- When it goes so does a tax deduction for amounts into the CER.
- Potential tax impact on unwinding of reserves; UK discussions underway on possible successor regime.

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