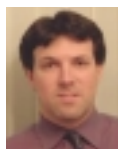


THE REALITY OF TAX REGULATION



TREASURERS OVERSEEING FUNDING OF OVERSEAS GROUP FIRMS COULD FIND THEMSELVES IN HOT WATER FOR FAILING TO COMPLY WITH THE TAXES ACT OF 1988, WARNS **MATTHEW ROSE** AMCT OF BT.

This article covers in greater detail an area mentioned briefly in 'More than the sum of the parts' in *The Treasurer* in September 2002. Treasury consent is an important factor that tax colleagues in your organisation may often cite in advising you or structuring your group's financing arrangements. This does not refer to seeking your group treasurer's support for transactions, which may, of course, be necessary. In short, the rules need to be considered for all transactions involving equity or debt funding of overseas group companies.

Failure to comply with the relevant sections (765 and 765a of the Taxes Act 1988) can, in addition to financial penalties, also give rise to criminal sanctions, including a jail sentence, for anyone party to the transaction in question. While no one has yet been sent to jail under this section the threat is always there. Therefore, it is a key area where tax and treasury professionals must work together.

CAUSES FOR CONCERN. Section 765 and 765A of the Taxes Act 1988 cover transactions undertaken by, or in respect of, overseas subsidiaries of UK tax-resident companies. These may require UK companies to seek advance clearance from HM Treasury (although in practice from the Inland Revenue) for various transactions they or their subsidiaries wish to undertake. This is especially so where a cross-border transaction (whether of shares, depositing or lending funds) between controlled subsidiaries take place or if the issue of redeemable shares is proposed.

It is assumed the UK parent controls all subsidiaries, even if there are intermediate holding companies or shareholdings are split over various parts of the group, and that the parent knows of transactions its subsidiaries plan to enter into, even if the parent is not a party to them. This is therefore crucial, and means that group treasury and tax functions in UK multi-nationals need to develop procedures to become aware of proposed transactions between subsidiaries and potentially restructure them before they take place.

This can be a real concern where delegation of authorities is passed down within a group or where, for example, a UK group may have a majority-owned listed subsidiary that has its own divisions operating largely independently. Cross-border transactions among the sub-groups can still be affected and the UK parent deemed

knowledgeable, even if not actively involved. To follow is a brief summary of the main aspects of Treasury consent, but is not intended to be a comprehensive guide to all circumstances. References to companies cited in the examples are primarily with regard to where they are resident for tax purposes, as opposed to where they may be incorporated (if different).

AFFECTED TRANSACTIONS. The following transactions fall under sections 765 and 765a of the Taxes Act 1988:

- any creation or issuance of debentures (borrowings evidenced in writing) by the non-UK resident subsidiary;
- any creation or issuance of shares by the non-UK resident subsidiary; and
- any transfer of shares or debentures of the non-UK resident subsidiary.

The transfer of even a minority of any shares or only part of any debentures is still affected if the UK parent has ultimate control over the subsidiary. Note that creation, issuance and transfers of shares or debentures of UK tax-resident companies are not affected by the treasury consent legislation. Therefore in general, loans to UK companies are permitted.

ACTION STATIONS. If a proposed transaction arises, there are several actions the treasurer can take, which are explained below:

- the proposed transaction may fall within a 'general consent';
- an advance application may be needed for 'special consent'; or
- if the transaction is within the EU, then a notification within six months after the transaction is sufficient.

GENERAL CONSENTS. A number of general consents, being permitted transactions without seeking advance clearance, are available. In general, these allow:

- creation of shares in new or existing companies;
- shares or debentures to be issued by (or transferred between)

Examples of transactions needing special consent

- A UK plc or another UK group company wishing to acquire (or dispose of) shares in a non-UK subsidiary from (to) a group subsidiary outside the EU.
- A group company in one territory wishing to transfer shares in a non-UK subsidiary to another group subsidiary in a different territory, where transferor and transferee are not both within the EU.
- A group subsidiary outside the EU wishing to borrow funds (issue of a debenture) from another group company other than in the UK or its own territory.
- A group subsidiary outside the EU seeking to issue shares to a non-UK group company, which is not an existing shareholder.

Examples of transactions falling within general consents

- A UK plc or another UK group company wishing to acquire (or dispose of) shares in a non-UK subsidiary from (to) a UK group subsidiary.
- A group company in one territory wishing to transfer shares in a non-UK subsidiary to another group subsidiary in the same territory.
- A group subsidiary outside the EU wishing to borrow funds (issue of a debenture) from a UK plc or another UK group company for use in its business and not for redepositing with a UK company.
- A group subsidiary outside the EU seeking to issue shares to all of its existing shareholders, with a reasonable expectation all will subscribe.

Examples of EU transactions requiring notification within six months after the event

- A UK plc or another UK group company acquiring (or disposing of) shares in a non-UK subsidiary from (to) a subsidiary within the EU.
- A group company in one EU territory transferring shares in a non-UK subsidiary to another group subsidiary in a different EU territory.
- A group subsidiary within the EU wishing to borrow funds (issue of a debenture) from another group company in the EU, other than in the UK or its own territory.
- A group subsidiary within the EU seeking to issue shares to a non-UK group EU company not an existing shareholder.

- overseas companies to another company in the same territory.
- Transactions with unconnected or third parties (as long as these are not conduits for intra-group transactions);
- rights issues for subsidiaries to all shareholders (unless it is unlikely all will take up their rights);
- issues of debentures to (or borrowing from) UK-resident companies (with some exceptions if funds are being round-tripped);
- issues of shares to UK-resident firms (with some exceptions and other consequences such as the values used may need to be considered if an issue of shares is being made not solely to existing shareholders); or
- transfers between UK-resident companies of shares or debentures.

SPECIAL CONSENT. If a transaction requires consent and does not fall within general consents, then an application for special consent is needed. An application, usually in the form of a letter containing details of and reasons for the proposed transaction, any effects on UK tax plus copies of specified accounts, is required and is submitted to the Treasury with a copy to the Inland Revenue.

A response is usually received within one month, although questions can be asked and requests can be rejected. If accepted, the consent for the proposed transactions usually lasts for 12 months from the end of the month in which the response is sent.

TRANSACTIONS WITHIN THE EU. To enable freedom of movement of capital within the EU, transactions, that involve the movement of funds entirely within the EU, may take place without advance consent, but must be notified to the Inland Revenue within six months following the transaction (section 765A).

BE PREPARED. Many tax professionals believe the rules are currently too restrictive (especially as exchange controls were relaxed in 1979) and should either be repealed or turned into solely a post-transaction notification exercise. However, seeking clearance from the Inland Revenue (or having to structure transactions differently) is something UK groups must consider often in external transactions, and clearance often has to be sought.

This might also affect the competitiveness of the UK for location of holding companies, and UK-parented quoted groups will struggle not to be affected.

In some cases, special consent applications can be straightforward, but in others the Inland Revenue can ask questions that lead to a delay in implementing transactions or even restructuring proposals, with the outcome being a less favourable structure.

This also provides the Inland Revenue with information regarding the nature of certain transactions over which it may not otherwise have visibility and the Revenue may be able to use the enquiries to help protect the tax base of the UK.

Alternatively, at the very least, the Inland Revenue will obtain details in advance of normal dates for submission of tax returns, which may affect any subsequent enquiries.

This is therefore an important area where treasury and tax professionals need to communicate frequently, both to avoid breaching rules in these sections of legislation and to help in managing tax risks and potential exposures.

Matthew Rose AMCT is Senior Tax Manager of BT Group Tax.
matthew.rose@bt.com
www.bt.com