The Association of Corporate Treasurers

Comments in response to
Consultation on Controlled Foreign Companies (CFC) reform
HM Treasury and HM Revenue & Customs,
June 2011

September 2011

The Association of Corporate Treasurers (ACT)

The ACT is a professional body for those working in corporate treasury, risk and corporate finance.   Further information is provided at the back of these comments and on our website www.treasurers.org.

Contact details are also at the back of these comments.

We canvas the opinion of our members through seminars and conferences, our monthly e-newsletter to members and others, *The Treasurer magazine*, topic-specific working groups and our Policy and Technical Committee.

General

The ACT welcomes the opportunity to comment on this matter.

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The ACT agrees with the government's objective of having a Controlled Foreign Company (CFC) regime that strikes a balance between a more competitive UK corporate tax system and providing adequate protection of the UK tax base.

Whilst we acknowledge that FCPE improves the competitiveness of UK corporate tax, we note that the current proposal will encourage UK firms, who haven't done so already, to set up overseas finance companies for their non-UK inter group funding. Apart from the additional cost and complexity this has the potential to transfer treasury positions currently performed in the UK to overseas entities, resulting in a loss of UK jobs and/or a transfer of skills overseas. Although not part of the CFC tax regime, we would encourage HMRC to give local UK finance and treasury companies the same tax concessions as CFCs. This would encourage multinationals to base their European funding and treasury activities in one central place, namely the UK, instead of establishing overseas entities.

Usually it is only large corporates who establish separate off shore finance companies and then not all do. The majority of treasuries for medium to large size corporates are structured as divisions or functions and are not structured as separate finance companies.

Our response focuses on the proposed finance company rules and we have only answered questions in section 6 “Finance Company Rules” of the consultation document.

Finance company rules

It is proposed that a finance company partial exemption (FCPE) is applied to overseas financing that will usually tax a quarter of overseas intra-group finance income. The consultation document states that in most situations this will result in an effective UK corporate tax rate of 5.75% on profits from overseas intra-group finance income by the year 2014.

FCPE Design options

The government has proposed both a simple and a number of more flexible options to tax CFCs.

- The simple option is to apply FCPE to wholly equity funded CFCs that only lend to other overseas group companies that are not themselves subject to a CFC apportionment (including not being subject to a partial apportionment under FCPE). One quarter of the chargeable profits of the finance company would be subject to an apportionment to the UK.
- Option A comprises a mechanical set of rules that focuses on chargeable finance income of the CFC.
- Option B is similar to option A but focuses on chargeable finance profits of the CFC.
- Option C is similar to the simple option in that it apportions one quarter of chargeable finance profits of the CFC, however does not accurately reflect the debt:equity ratio if the finance company is debt funded (i.e. interest on UK intercompany loan funding is fully taxable in the UK but is deductible on only a proportionate basis in the CFC).

Question 6A: Do the businesses prefer the simplest option, one of the more flexible options or an alternative approach? Would the benefits of the simplest option outweigh the cost of any intra-group debt restructuring where required?

The simplest option is highly inflexible and would require significant restructuring for the majority of current finance companies. Restructuring of the CFC would include removing all non financing activities, removing UK loans and all sources of debt funding for the

CFC. These constraints may not allow the CFC to manage its local tax liability. We therefore do not favour this option.

Options A and B both provide more flexibility and are hence suited to corporates where the CFC has some debt funding. The examples provided in the consultation document are rather simplistic as they do not consider funding in foreign currencies. The treatment of foreign exchange gains/losses at the CFC level needs to be considered as it may make one option more preferable to another. We would recommend that guidance and illustrative examples are provided on foreign denominated loans.

Option C is described in the consultation document as the simplest and most pragmatic of the flexible options. However where debt funding exists it provides only partial relief on the intercompany interest expense and hence a different apportionment than options A and B.

Given that different options are appropriate for different levels of funding complexity we recommend that corporates are able to elect a method from options A, B or C. Increased tax avoidance risk due to the ability to elect a method could be reduced by not allowing retrospective election and only allowing an entity to change methods if specific conditions have been met.

Interaction with treasury management

Where treasury company activities exist within the same entity as finance company activities, the proposal is that finance company rules should apply to the combined activity. If the treasury company activities exist within their own entity then the government aims to exempt them under the general purpose exemptions.

Question 6B: Do businesses agree that the proposed treatment of companies that carry out both treasury and finance company activities is a satisfactory approach? If not, do businesses consider that it would be practical to separately identify the profits from treasury and finance activities?

Treasury functions are usually set up as cost centres and typically only make a relatively small income from interest rate spreads in cash pooling structures and foreign exchange spreads when hedging on behalf of group companies. However large profits and losses can arise from foreign exchange movements on the revaluation of monetary assets and liabilities to the extent they have not been hedged (a policy choice).

A treasury function's primary responsibilities include funding the business, managing the cash and liquidity, and hedging where appropriate the interest rate and foreign exchange exposures that arise. Treasury and funding activity are often mixed and performed by the same treasury team. We do not agree that treasury activities should be taxed simply because they are in a company structure with combined activities. We also believe that requiring a treasury company to be separately established in order to be exempt from tax adds unnecessary complexity.

Whilst in principal it should be possible to split the profits of treasury activities from financing activities, in practice this would be quite onerous to record the activities separately. Apportioning the profits on a reasonable basis may be a more workable approach.

Question 6C: Do businesses agree that applying the General Purpose Exemption (GPE) to treasury companies is an appropriate approach to exempt them from the rules?

We welcome the acknowledgement that treasury activity should be exempt.

The GPE exemptions are quite broad. The more certainty on exempting treasury companies the better and hence it would be helpful if guidance is produced on how bona fide treasury centres should get the GPE exemption.

Mixed activity companies

Question 6G: Based on the design options available, do you think that the finance company rules should apply to mixed activity companies, despite the added complexity? If so, what would be the most appropriate way to identify the profit arising from each activity?

We do not believe that a group should have to set up a separate finance company in order to achieve FCPE and hence the rules should apply to mixed activity companies.

For purely operational reasons it is not unusual for a finance company to have external bank borrowings as well as intra-group dealings. The allocation of interest expense and income needs to be split by treasury activity (e.g. bank deposits, bank borrowings) and intra-group funding activities. As previously noted the treatment of foreign exchange gains/losses also needs to be considered and potentially split along the same lines.

Transitional rules

Question 6H: Would any practical issues arise if the design option chosen meant that intra-group debt had to be restructured? How long would it take to restructure such arrangements?

Restructuring inter-group debt can involve significant time and costs and we would stress that additional complexity such as this should be avoided.

Application of the finance company rules to branches

Question 6J: Would it be of benefit to consider the application of these rules to branches at this stage despite the practical difficulties and issues raised?

As noted above it should not matter how the treasury activities are structured. Overseas branches may exist, for example, in order to meet local regulation and tax authority requirements.

The Association of Corporate Treasurers

The Association of Corporate Treasurers (ACT) is the leading professional body for international treasury providing the widest scope of benchmark qualifications for those working in treasury, risk and corporate finance. Membership is by examination. We define standards, promote best practice and support continuing professional development. We are the professional voice of corporate treasury, representing our members.

Our 4,200 members work widely in companies of all sizes through industry, commerce and professional service firms.

For further information visit www.treasurers.org

Guidelines about our approach to policy and technical matters are available at http://www.treasurers.org/technical/manifesto.

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