Faculty of Taxation

Tax Representation

TAXREP 10/03

DUAL RESIDENT COMPANIES REMAINING WITHIN THE CFC REGIME
Section 90, FA 2002

Letter submitted in April 2003 to the Inland Revenue Policy Division International in relation to the provisions in section 90, FA 2002

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DUAL RESIDENT COMPANIES REMAINING WITHIN THE CFC REGIME
Section 90, FA 2002

INTRODUCTION

1. We have set out below the contents of the letter submitted by the Tax Faculty to the Inland Revenue Policy International in connection with the provisions in section 90, FA 2002 which provide for dual resident companies to remain permanently within the CFC regime.

WHO WE ARE

2. The Institute is the largest accountancy body in Europe, with more than 123,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

3. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry (DTI) through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy (which includes taxation).

4. The Tax Faculty is the focus for tax within the Institute. It is responsible for technical tax submissions on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter "TAXline" to more than 11,000 members of the ICAEW who pay an additional subscription.

LETTER TO THE EUROPEAN COMMISSION

5. The text of the letter sent to Inland Revenue Policy International is reproduced below:

   "Section 90, FA 2002 – Controlled foreign companies and treaty non-resident companies

   This provision was introduced as part of the measures exempting gains and losses on disposals of substantial shareholdings (the 'SSE exemption').

   In the consultations prior to the introduction of the SSE exemption, the Treasury expressed concern that the proposed exemption could put a substantial part of the UK tax base at risk if it was not accompanied by revenue protection measures countering changes of residence driven by fiscal considerations. There were four possible ways of achieving this protection but the one finally chosen and enacted is section 90. FA 2002 which introduces a new section 747(1B) into ICTA 1988.

The section is concerned with dual resident companies that would, under the terms of a Double Tax Treaty between the UK and the other country in which the company is resident, be treated as resident in that other country. Such companies are normally deemed to be non resident for all tax purposes by section 249, FA 1994.

New section 747(1B) now disapplies section 249 for the purposes of the controlled foreign company (CFC) rules.

This has two practical effects:

- the emigrated company is taken into account in determining whether a CFC is controlled by persons resident in the UK (section 747(1)(b)); and

- any chargeable profits of the CFC may be attributed to the emigrated company and subject to corporation tax (section 747(4)).

There is no protection under any relevant Double Tax Agreement for the attributed CFC profits following the Court of Appeal's decision in the Bricom case.

In our representation on the 2002 Finance Bill, we expressed our concern with this clause and asked that it be removed from the Bill. Our request was refused by the Revenue, for the reasons given in the Appendix.

We understand the Government's concern that the new SSE exemption should not be abused but we remain unconvinced that this provision is an appropriate response to that concern. We believe that to treat such emigrated companies as permanently falling within the UK CFC regime is a disproportionate response to this concern. As we stated in our earlier representation, the CFC rules are designed to protect the UK tax base, but we do not see why a non-resident company should potentially be permanently within the UK tax base as a result of the introduction of the SSE. We remain of this view.

You may be aware that the EC has written to both France and Finland, under Article 226 of the EC Treaty, requesting them to justify their respective CFC regimes. In the circumstances, it is anomalous for the UK to rely on extension of a provision which the EC and probably ultimately the ECJ considers to be contrary to the freedom of establishment in the EC Treaty.

Moreover, last summer, in the Groupe Schneider Electric SA case, the French Court reached the opposite conclusion to the UK in that French double tax treaties may override French domestic CFC legislation.

Furthermore, in a recent (13 March '03) opinion the ECJ's Advocate–General opinion was that the French personal tax emigration toll charge was contrary to the freedom of establishment of the EC Treaty and that such breach of the EC Treaty could not be justified.

We urge the Government to look again at this provision and consider removing it from the Statute Book."

6. We have reproduced the Tax Faculty Representations on Section 90 FA 2002 and the Inland Revenue response in the Appendix.

IKY
2-04-03

Appendix

Tax Faculty Representation in relation to FA 2002 section 90 and Inland Revenue response

Clause 89 (section 90): Controlled foreign companies and treaty non-resident companies

1. We have already made in the point in the Working Group discussions on the substantial shareholdings consultation that we do not think that this provision is necessary. We remain of that view and think that the clause should be deleted. It is anomalous that a company which has ceased to be resident in the UK and no longer within the scope to UK corporation tax could remain resident in the UK for this purpose. The CFC rules are designed to protect the UK tax base, but we do not see why a non-resident company should potentially be within the UK tax base.

2. Once again, we have some concerns whether this provision might be held to be illegal under EU law as a restriction on the freedom of establishment principle. We are aware of a German case (Uberseering) currently before the ECJ where a similar provision in German corporate law was held by the Advocate General to be contrary to the EU treaty.

3. Furthermore, the company concerned will always remain subject to the application of this provision. If the Government believes that such a provision is necessary, then there should be a time limit put on its application.

Revenue response

You say that:

i. *you do not think that this clause is necessary and that, if the Government believes that it is necessary, there should be a time limit put on its application;*

ii. *it is anomalous that a company which has ceased to be resident in the UK and no longer within the scope to UK corporation tax could remain resident in the UK for this purpose; and*

iii. *the clause might be held to be illegal under EU law as a restriction on the freedom of establishment principle.*

With regard to i), as you know, we do think that the clause is necessary. You may recall that, during the consultation process, there was a general agreement that a revenue protection measure was appropriate (though, admittedly, less consensus about the form that revenue protection measure should take) and that the approach taken by the clause was adopted after careful examination of alternative options. We can confirm that its effectiveness will be kept under close review.

We do not think that a time limit would be appropriate. Its effect would be to restrict the continued application of the UK's CFC rules to a limited period of time – whether *or not the migration was wholly artificial, and whether or not the substance of the company's operations remained in the UK. That would enable companies to indulge in artificial migration schemes at relatively little cost. They would be subject to the CFC rules for a limited period but be free to divert profits from the UK for ever after.*

We do of course recognise that there is a legitimate concern over companies which migrate for genuine, non-tax driven reasons but such companies will not, in practice be affected. The CFC rules only apply to companies where one of the main reasons for their existence is to achieve a reduction in UK tax by a diversion of profits from the UK.

Now, some companies which migrate for genuine, non-tax driven reasons might, of course, be faced with an unwelcome burden in complying with the administrative requirements of the CFC rules. As you know, however, we already operate a CFC clearance system which, in certain circumstances, can amount to an across the board clearance for all a company's CFCs. We said during the consultation process that we would be extending this clearance system, where appropriate, to companies that have left the UK for genuine commercial, rather than fiscal, reasons.

Obviously, each clearance application will be dealt with on its merits but we would envisage such clearances, where appropriate, to be effective for between three and five years - and automatically renewable thereafter so long as the relevant facts, circumstances and applicable law remain unchanged and the company has laid all its cards face up on the table.

Such clearances are legally binding on us so long as the company has disclosed all the relevant facts so this should ensure that, not only will the clause not in practice affect those companies who migrate for genuine commercial reasons, but any residual compliance burdens for such companies will be minimal.

With regard to ii), it should be remembered that the clause only affects companies that are incorporated or centrally managed and controlled in the UK but which, for the purposes of a double taxation treaty are treated as resident outside the UK. Furthermore, in practice, it will only affect such companies if they are seeking to take advantage of the benefits of being located in the UK whilst also seeking to avoid paying their fair share of tax by indulging in artificial tax avoidance schemes. There does not appear to be anything anomalous in a clause that aims to limit the scope for such avoidance.

With regard to iii), as we said during the consultation process, our legal advice is that the clause is not at odds with EU law.