



TAXREP 15/12

(ICAEW REP 42/12)

ICAEW TAX REPRESENTATION

CONTROLLED FOREIGN COMPANIES (CFC) REFORM: A GATEWAY UPDATE

Comments submitted on 20 March 2012 by ICAEW Tax Faculty in response to HM Treasury and HMRC paper *Controlled Foreign Companies (CFC) Reform: a Gateway update* published on 29 February 2012

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the paper *Controlled Foreign Companies (CFC) reform: a Gateway update* published together with update draft legislation by HM Treasury and HM Revenue & Customs (HMRC) on 29 February 2012 at http://www.hm-treasury.gov.uk/d/condoc_cfc_reform_gateway_update.pdf
2. Information about the Tax Faculty and ICAEW is given below. We have also set out, in Appendix 1, the Tax Faculty's Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system.

WHO WE ARE

3. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 136,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
4. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
5. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including TAXline, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

KEY POINT SUMMARY

6. We welcome the updated version of the legislation and commend the Government for having listened to the many representations that have been made with respect to the original version of the Gateway contained in the draft legislation published on 6 December 2011.
7. We submitted our comments before Christmas in TAXREP 70/11 on the December draft provisions and the new version represents a very comprehensive rewrite on which we provide comments below.
8. We presume that it is now unlikely that a further revised draft will be issued before the full Finance Bill is published on 29 March but we hope that the Government will continue to listen to, and take on board, representations that are made re the Finance Bill so that the final legislation, in Finance Act 2012, can be as good as it can be and fit for its purpose of playing a key role in an international tax system that aspires to be the most competitive amongst the G20 countries.
9. We welcome the reordering of the legislation so that the Gateway is at the beginning of the CFC legislation.

DETAILED COMMENTS

Chapter 3 – The CFC Charge Gateway: Determining which (if any) of Chapters 4 to 8 applies

Section 371CA – Condition B

10. The second ‘commercially effective’ test is satisfied if the CFC is capable of running its own business and any activities carried on by connected companies in the UK are ‘capable of being replaced either by the CFC itself or by obtaining support from unconnected companies’ and the CFC would still be ‘a commercially effective stand-alone company.’ (paragraph A.13 of the Annex to the HMT/HMRC document *Controlled Foreign Companies (CFC) Reform: a Gateway update*).
11. It seems clear that this Gateway will be satisfied if routine services are carried out in the UK, such as via a shared service centre, but it would be helpful if there were further clarification as to how far up the supply chain functions one would be able to go and still satisfy this Gateway test.
12. Would it still be acceptable for some entrepreneurial activities/functions to continue to be carried on in the UK?
13. What happens where the UK is the lead country in a region e.g. Europe?
14. If there happens to be a highly qualified person in the CFC then it is unlikely that they would not carry out, in the CFC, the functions for which they are qualified. So for instance in the context of a Bank if there are persons in the CFC who are capable of being a part of a Credit Committee then it is not likely that they would refer back to the UK for Credit Committee decisions.

Section 371CA – Condition C

15. We have found it difficult to understand how this Condition will operate in practice.
16. The Gateway Update document refers only to tax liability or tax advantage whereas the draft legislation refers to ‘tax and duty’. Does this distinction have any significance?
17. In sub-clause 12 presumably the reference to ‘the law of any territory’ includes the UK?

Section 371CB Does Chapter 5 apply?

18. We are not clear how this initial Gateway filter will apply if the overseas subsidiary is very successful or has a considerable amount of customer deposits on which finance income arises.
19. Sub-clause (5)(a) refers to a ‘temporary or permanent prohibition on a CFC paying dividends’ but would that extend, for instance, to a local solvency test which prevents a distribution?

Section 371CE Does Chapter 6 apply?

20. Section 371UA has a very broad definition of "UK Connected Capital Contribution" the phrase used in section 371CE. It is very difficult to see how this will not catch a UK-parented banking group as it will be virtually certain that at some stage in the past some capital will have been provided by a UK bank. The only exception is likely to be where all of the capital of the foreign bank potentially subject to a CFC apportionment has been provided before the group had a UK parent.

Section 371CG

21. We found some of the language very convoluted, for instance sub-section (6)(b) which defines a ‘relevant document’ as:

‘a document which changes or replaces a document falling within paragraph (a) or a document which is a relevant document by virtue of this paragraph.’

Chapter 4 The CFC Charge Gateway: Profits attributable to UK SPFs
Section 371DC

22. We felt that this section was much improved by comparison with the earlier version.

Chapter 6 The CFC Charge Gateway: Trading Finance Profits

23. We believe that it would be reasonable to put in a ‘within the last six years’ test to take out very old arrangements.

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ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see icaew.com/en/technical/tax/tax-faculty/~media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx)