EXPLANATORY MEMORANDUM TO

THE CORPORATION TAX (TAX TREATMENT OF FINANCING COSTS AND INCOME) (ACCEPTABLE FINANCIAL STATEMENTS) REGULATIONS 2009

2009 No. 3217

1. This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs ("HMRC") and is laid before the House of Commons by Command of Her Majesty.

2. Purpose of the instrument

2.1 Schedule 15 to the Finance Act 2009 ("Schedule 15") contains provisions relating to the tax treatment of financing costs and income. Schedule 15 refers to the financial statements of a group of companies, and deals with the question whether those statements are "acceptable" for the purposes of computing amounts under Schedule 15. These Regulations provide that financial statements are acceptable if they meet specified conditions.

3. Matters of special interest to the Select Committee on Statutory Instruments

3.1 None.

4. Legislative Context

4.1 The Regulations will be made under powers included in paragraph 88(3)(b) of Schedule 15. This will be the first occasion on which those powers will be exercised.

4.2 The rules in Schedule 15 limit the amount of finance costs that a company brings into account in calculating its profits for corporation tax purposes. Where the net finance costs of the UK members of a group exceed the gross consolidated finance costs of the group the excess is disallowed.

4.3 The gross consolidated finance costs of the group are defined as certain specified amounts disclosed in the consolidated financial statements of the group. Where the financial statements of the group are "unacceptable" then the provisions of Schedule 15 will apply as if the group had drawn up financial statements using International Accounting Standards ("IAS"). IAS has the meaning given by section 50(2) of the Finance Act 2004.

4.4 Schedule 15 contains rules that determine whether financial statements are "acceptable" or not. Paragraph 88(3)(b) provides powers for HMRC to make regulations setting out conditions relating to accounting standards, principles or practice which, if met, will mean that financial statements are "acceptable" for the purposes of Schedule 15.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

- ***What is being done and why***

7.1 The policy intention underlying Schedule 15 is that UK companies and UK permanent establishments of non-UK companies carrying on a trade in the UK and which are members of a group should not be able to claim excessive finance costs in calculating their profits for corporation tax. Finance costs are excessive where in total the net finance costs of the UK members of the group exceed the gross consolidated finance costs of the group as a whole.

7.2 The policy intention is to apply Schedule 15 in a way that avoids the need to revisit the results of groups' normal accounting procedures as far as possible. To this end, it is the intention that the gross consolidated finance costs of the group as a whole should as far as possible be calculated based on amounts taken from the consolidated financial statements prepared by the group.

7.3 When it comes to measuring external finance expenses of the worldwide group, Schedule 15 generally assumes that IAS will apply. A large number of groups, both UK and foreign headed, do prepare consolidated financial statements in accordance with IAS.

7.4 Even where groups do not use IAS, their local generally accepted accounting practice ("GAAP") may well be based on or be very similar to international standards. These Regulations identify a number of local GAAPs considered not to differ materially from IAS and which are therefore considered "acceptable" for the purposes of Schedule 15. They also provide that IAS in the slightly modified form adopted by the European Commission are "acceptable".

8. Consultation outcome

8.1 A consultation document was published in December 2008 which provided draft clauses for Schedule 15. Those draft clauses provided that where the amounts disclosed in the financial statements of a group differed materially from those that would have been disclosed under IAS, then Schedule 15 would apply as if the group had prepared financial statements under IAS. The consultation document published with the draft clauses invited interested parties to consider ways in which the draft clauses could be extended to allow the use of local GAAP wherever possible. Various respondents commented

that there should be a list of overseas country GAAPs that are considered to be equivalent to IAS and thereby acceptable for determining amounts to be computed under Schedule 15. The government accepted this suggestion and rules within Schedule 15 provide regulating making powers to allow HMRC to specify local GAAPs that will be considered acceptable for the purposes of Schedule 15.

9. Guidance

9.1 HMRC will publish guidance on the operation of the Schedule, including the Regulations.

10. Impact

10.1 The impact on business, charities or voluntary bodies is positive as the Regulations will decrease the number of groups that will have to revisit their financial statements for the purposes of computing amounts under the provisions of Schedule 15.

10.2 The impact on the public sector is expected to be negligible.

10.3 Schedule 15, Finance Act 2009 is one of a package of measures introduced as part of the Government's review of the taxation of the foreign profits of companies. A full and final impact assessment of the effect the package as a whole will have on the costs of business and the voluntary sector was published on 22nd April 2009. A copy is available at http://www.hm-treasury.gov.uk/d/Budget2009/bud09_impactassessment_1395.pdf.

11. Regulating small business

11.1 The legislation will not apply to small business.

12. Monitoring & review

12.1 HMRC intend to monitor the list of acceptable local GAAPs and update or amend it as necessary.

13. Contact

Sue Davies at HM Revenue and Customs (Tel: 020 7147 2565 or email: sue.davies2@hmrc.gsi.gov.uk) can answer any queries regarding the instrument.