EXPLANATORY MEMORANDUM TO

THE TAX TREATMENT OF FINANCING COSTS AND INCOME (CHANGE OF ACCOUNTING STANDARDS: INVESTMENT ENTITIES) REGULATIONS 2015

2015 No. 662

1. This explanatory memorandum has been prepared by HMRC and is laid before the House of Commons by Command of Her Majesty.

This memorandum contains information for the Select Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 Part 7 of the Taxation (International and Other Provisions) Act 2010 ("TIOPA2010") includes provisions which set a ceiling (known as the "debt cap") on the total interest and other specified financing expenses for which corporation tax deductions are available to UK members of a worldwide group of companies that are subject to corporation tax.

2.2 The ceiling is calculated by reference to the difference between the financing expenses of the members of the worldwide group which are subject to corporation tax and the amount (called the "available amount") disclosed in the accounts of the worldwide group in respect of specified financing costs. The purpose of these Regulations is to address a practical issue that arises from changes to accounting standards which would otherwise reduce the available amount.

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

3.1 The changes to International Financial Reporting Standard 10 (IFRS 10) were issued in October 2012 and Financial Reporting Standard 102 (FRS 102) was issued in March 2013. The amendments to IFRS 10 apply mandatorily for periods of account beginning on or after 1 January 2014. Companies using UK Generally Accepted Accounting Principles (UK GAAP) will be required to adopt FRS 102 for accounting periods beginning on or after 1 January 2015. However, early adoption of the changes to IFRS 10 or of FRS 102 is permitted. The instrument has potential retrospective effect so that finance expenses are not disallowed as a result of the changes to accounting standards whenever they are adopted.

3.2 HMRC regret that on this occasion it has not been possible to adhere to the "spirit" of the "21 day rule" as Parliament will prorogue ahead of the General Election less than 21 days before Regulations will come into force. However, to ensure certainty for business it was felt necessary to bring the Regulations into force at the earliest date once the issue had been identified with stakeholders.

4. Legislative Context

4.1 Part 7 of TIOPA 2010 (originally Schedule 15 to the Finance Act 2009) is one of several measures introduced as part of the Government's review of the taxation of the foreign profits of companies. It contains the rules for calculating the amount of financing expenses to be disallowed in the computation of a group member's corporation tax liability where the available amount is less than the financing expenses of the members of the worldwide group.

4.2 Section 332(1) provides that the available amount for a period of account of the worldwide group is the sum of certain amounts disclosed in the financial statements of the group for that period. Section 346(2) defines 'financial statements of the worldwide group' as consolidated financial statements of the ultimate parent and its subsidiaries.

4.3 To ensure that UK and non-UK headed groups are treated the same for the debt cap rules they must use either International Accounting Standards (IAS) or UK GAAP. IFRS 10 is the IAS setting out the principles for presenting and preparing consolidated financial statements when an entity controls one or more entities. IFRS 10 was amended in 2012 and FRS 102 issued in 2013 is applied by large and medium companies which do not apply IFRS.

4.4 The particular changes to International Accounting Standards to which these regulations relate apply to an 'investment entity'. This is, in essence, an entity which holds investments for investors and where the performance of its investments is measured on a fair value basis. In some cases, if the investment entity has a subsidiary or subsidiaries, it prepares consolidated accounts, but it does not consolidate subsidiaries held as investments managed on a fair value basis. Instead it discloses them as investments held at fair value. In other circumstances, it is required not to prepare consolidated accounts at all but only single entity accounts in which, again, it discloses all of its subsidiaries as investments held at fair value. In both cases the effect is that if a subsidiary of an investment entity has an external debt liability, that liability will not be disclosed in the parent's consolidated financial statements. The cost of funding any liability will, however, continue to form part of the amount of the UK subsidiary's net finance expenses. FRS 102 does not use the term 'investment entity', but the same effects can arise from the application of paragraph 9.9 of that standard, in similar circumstances. In either case, this could result in the disallowance of finance costs which were allowed before the changes to accounting standards.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

The Financial Secretary to the Treasury has made the following statement regarding Human Rights:

In my view the provisions of The Tax Treatment of Financing Costs and Income (Change of Accounting Standards: Investment Entities) Regulations 2015 are compatible with the Convention rights.

7. Policy background

- What is being done and why

7.1 The provisions of Part 7 TIOPA are amended to increase the available amount of a worldwide group by a financing expense amount of a UK group company, or an expense arising to a member of the worldwide group that is not a UK group company, where that amount would be taken into account in calculating the available amount were it not for the operation of IFRS 10 or FRS 102.

8. Consultation outcome

8.1 There was no formal consultation on this change. It was made in response to concerns raised by a small number of representatives of large groups in order to ensure that these groups did not incur unintended corporation tax charges under the debt cap rules as a result of changes to accounting standards.

9. Guidance

9.1 HMRC will update the guidance in the Corporate Finance Manual to reflect the fact that these Regulations are being made.

10. Impact

10.1 The impact on business, charities or voluntary bodies is to ensure that certain large groups do not incur unintended corporation tax charges as a result of changes to accounting standards.

10.2 This change has no impact on the public sector.

10.3 A Tax Information and Impact Note covering this instrument will be published on the website at https://www.gov.uk/government/collections/tax-information-and-impact-notes-tiins

11. Regulating small business

11.1 The legislation does not apply to small business.

12. Monitoring & review

12.1 HMRC will review the Regulations in 2015 and 2016 to determine whether they operate as intended.

13. Contact

Judith Diamond at HM Revenue and Customs Tel: 03000 585712 or email: judith.diamond@hmrc.gsi.gov.uk can answer any queries regarding the instrument.