HMRC - CFM95220 - Rules: Interest Capacity, Allowances And Disallowances

CFM95220 Interest restriction: Core rules: Interest capacity, allowances and disallowances

A worldwide group will suffer a disallowance where its aggregate net taxinterest expense for the period of account exceeds its interest capacity for the period. This excess is known as the total disallowed amount (TIOPA10/S373(2).

In the simple case, where no amounts are brought forward, the interest capacity will be the greater of the basic interest allowance for the period of account or the £2 million per annum de minimis amount. Where periods of account are not exactly 12 months long, including on commencement, where a period is treated as starting on 1 April 2017, the de minimis amount for the period is computed pro-rata by day count.

Aggregate net tax-interest expense

The worldwide group’s aggregate net tax-interest expense, as its name suggests, is computed by aggregating amounts of tax-interest of companies in the group. To work out the aggregate net tax-interest expense, it is first necessary to determine the net tax-interest expense or income of each relevant company in respect of the group’s period of account. A relevant company is one that is a member of the group for all or part of a period of account. As the amounts concerned are amounts taken into account for corporation tax (or those that would be but for these rules), only companies subject to corporation tax need be considered.

For each company, these amounts are determined by identifying tax-interest income and expense amounts in respect of the group’s period of account and aggregating those amounts. This will result in either net tax-interest expense where expenses exceed income, or net tax-interest income where income exceed expenses. If a company has net tax-interest expense its net tax-interest income amount is zero and vice versa. There are rules dealing with disregarded periods where company accounting periods do not coincide with the group’s period of account, or a company joins or leaves a group part way through a period.

To compute the group’s aggregate net tax-interest expense the sum of the net tax-interest income amounts for all relevant companies is subtracted from the sum of net tax-interest expense amounts (no company can have both). If the result of this is a negative number, that is the group’s aggregate net tax interest income for the period of account.

Note that although the amount is referred to as the aggregate tax-interest expense of a worldwide group, only amounts relating to UK group companies are taken into account in the calculation.

Example

The aggregate net tax-interest expense of 50 is the same as the sum of all the companies’ tax-interest expense amounts, 210, less the sum of all their tax-interest income amounts, 160. In this calculation, no distinction is made between intra-group and external amounts.

Interest capacity and interest allowance

The rules use two closely related concepts: interest capacity and interest allowance. The interest capacity, which takes into account the de minimis amount, limits the amount of aggregate net tax-interest expense arising in the current period that can be deducted. The interest allowance is a function of any aggregate tax-EBITDA and any aggregate net tax-interest income for the period. The interest allowance feeds into the interest capacity, but it is the unused interest allowance that can be carried forward or used to reactivate carried forward tax-interest expense.

The interaction between interest capacity and interest allowance prevents de minimis amounts from being carried forward or being used in place of carried forward interest allowance.

Interest capacity

The interest capacity, the figure actually taken into account in computing disallowances, is calculated from the basic interest allowance and augmented by any unused interest allowance for earlier years. It is also subject to the de minimis limit, set at £2 million per annum. Where the period of account is longer or shorter than a year, the de minimis amount available for the period is adjusted proportionately.

Interest allowance

Basic interest allowance

The processes required to compute the ‘basic interest allowance’ are more complex than computing the aggregate net tax-interest expense, as more than one test is applied, and there is a choice of two methods; the fixed ratio method and the group ratio method.

Interest allowance

The interest allowance for the period is the sum of the basic interest allowance and the aggregate net tax-interest income for the period of account. This aspect of the calculation is only relevant to amounts carried forward, because if there is aggregate net tax-interest income in a period there is no aggregate net tax-interest expense is to restrict.

What happens to disallowances?

Normally a group will have appointed a reporting company which will allocate any disallowances to UK group companies and then to accounting periods falling at least partly within the group’s period of account. The allocated amounts reduce the company’s net deduction for tax-interest expense for its accounting period. There is a default order in which different types of tax-interest expense deductions are disallowed, which the company may elect to vary.

If a group has no reporting company each company’s allocation will be a pro-rata share of the group’s total disallowed amount. Pro-rata allocations are proportional to a company’s share of group net tax-interest expense. In groups with a reporting company, the pro-rata amount is also the maximum disallowance that can be allocated to a group member that has opted not to consent to discretionary allocations made by the reporting company.

The amounts disallowed at company level become a tax attribute of the company. Disallowed amounts may be reactivated in subsequent periods of account to the extent the group’s interest allowance exceeds its aggregate tax-interest expense for the period. The group can elect which companies reactivate the amounts they carry forward. Reactivated amounts are treated as current period expenses of the same type as the amounts previously disallowed.