HMRC - CFM97505 - Groups: Overview

Broadly speaking, banking and insurance groups are subject to Corporate Interest Restriction in the same way as other groups. However, there are some adjustments to the main rules to ensure that they work in the way intended and without any unexpected consequences. These adjustments are explained separately for banks and for insurers.

The OECD Report

Although banking and insurance groups are fundamentally different in terms of their business and funding models, the OECD report identified a number of common features which are important to understand.

In both cases third party interest income is vitally important to profitability and liquidity and plays a role that is fundamentally different to that for most other businesses. For most banks, interest income and expense are largely operating items comparable with revenue and cost of sales for entities in nonfinancial sectors. For insurance companies, interest income is a major form of investment income used to meet liabilities as they fall due.

Secondly, both are subject to strict regulatory rules, and commercial constraints, which require them to hold minimum levels of equity and restricts their ability to place excessive levels of debt in particular entities or to use debt to fund equity investments in subsidiaries.

Thirdly, both are key providers of debt finance to groups in other sectors, either as lenders or as investors in corporate bonds.

For these reasons banking and insurance businesses are expected to be in a net interest income rather than net interest expense position, and the risk of base erosion or profit shifting due to excessive interest expense is addressed to a large extent by capital regulation.

In light of this, the OECD gave recommendations where no material risks are identified, for example where potential risks are already addressed by existing regulatory capital rules and/or tax rules. In such cases it is not expected that the country should introduce new rules to deal with a risk that does not exist or is already addressed. A country may reasonably exempt banking and/or insurance groups from the fixed ratio rule and group ratio rule without the need for additional tax rules. Where BEPS risks involving interest are identified, a country should introduce rules which are appropriate to address these risks, taking into account the regulatory regime and tax system in that country.

The Corporate Interest Restriction rules implement this recommendation by keeping banking and insurance companies within the scope of the rules, but making modifications to the definition of tax-interest appropriate to each sector. These modifications mean that the rules work as intended in these sectors and limit the compliance burden for many banking and insurance groups, reflecting the amount of risk in each group.

What this means in practice?

Simple cases

It is expected that most groups whose UK activities largely consist of banking or insurance will be in a net tax-interest income position by some margin. Even in the event of temporarily falling into a net tax-interest expense position the ability to carry forward interest allowance may mean that no restriction arises. The interest allowance carried forward would include net tax-interest income from the preceding five years.

HMRC expects that such groups will be able to establish with sufficient certainty that they are not subject to restriction without performing detailed calculations. Providing a group remains in a clear net tax-interest income position over a rolling five-year cycle, to take reasonable care in preparing its returns it should suffice for the group to:

establish the period of account and its membership; and

make a reasonable estimate of its tax-interest position for the period.

Assuming a reporting company has been appointed by the group or HMRC, it will be able to submit an abbreviated return confirming that it is not subject to a restriction in the period.

Note that where a banking group wishes to carry forward surplus interest allowance to a later period (eg. because it is in a net tax-interest expense position in the later period) then it will need to file a full interest restriction return for the earlier periods. A reasonable estimate of figures prepared on a prudent basis should be satisfactory for this.

So long as the group has submitted an abbreviated interest restriction return, an extended time limit allows a full interest restriction return to have effect if it is received within five years of the end of the period of account.

Other cases

However, where, for example, a UK holding company of a banking or insurance group issues debt to fund non-UK activities, or group entities carry on significant amounts of activity not connected with the banking or insurance business, then the position may not be so clear. For a “mixed” group which combines non-financial business with a regulated banking or insurance company, the position will depend on the relative proportion of the UK banking or insurance business in relation to the other activities of the group.

In such cases the group will need to perform a high level review to determine whether the amount of tax-interest income which it receives exceeds its taxinterest expense. Assuming that its tax-interest income exceeds tax-interest expense by some margin, then detailed calculations would not normally be necessary. Where, however, tax-interest expense exceeds tax-interest income or where the amounts are very similar, then additional work is likely to be necessary to calculate these amounts more accurately.

Next page