HMRC - CFM98250 - Rules: Excess Debt Cap

TIOPA10/S400

Excess debt cap can arise where there is an interest disallowance in a period and the debt cap is not the limiting factor in computing a group’s basic interest allowance for a period (S400). Excess debt cap can arise if either the fixed ratio method or the group ratio method is applied.

Where the fixed ratio method applies, excess debt cap for a period of account is the fixed ratio debt cap as calculated by reference to on the group’s adjusted net group-interest expense - (ANGIE) less the fixed ratio, 30%, of aggregate tax-EBITDA.

Where the group ratio method applies, excess debt cap for a period of account is the group ratio debt cap as calculated by reference to the group’s qualifying net group-interest expense (QNGIE), less the group ratio percentage of aggregate net tax-interest expense.

Unlike interest allowance, which can be carried forward up to five years, excess debt cap can only carry forward from one period to the next period. However, it can been seen below that the debt cap brought forward from the immediately preceding period may have the effect of increasing the amount that can be carried forward to the following period. As such, an amount of excess debt cap can, in effect, be carried forward indefinitely.

There is a limit on the amount of excess debt cap that can be carried forward, the carried forward limit. This is the sum of the total disallowed amount for that period, plus excess debt cap, if any, from the period immediately before the period of account. This therefore limits the increase in the excess debt cap that arises in a period to the amount of the disallowance that has arisen in the period.

The excess debt cap carry-forward is of practical significance for a group where the factor limiting interest allowance sometimes the fixed ratio or group ratio percentage of aggregate tax-EBITDA, and sometimes the debt cap. Example 1 illustrates a scenario where in the first period of account, the limiting factor is aggregate tax-EBITDA multiplied by the fixed ratio, but in the second would be the debt cap, but for excess debt cap brought forward.

The excess debt cap is available in the next period even if the group switches from applying the fixed ratio method to the group ratio method, or vice versa; there is no need to recalculate the figure on a different basis when this happens. See Example 3.

The examples of carried forward debt cap also inevitably illustrate other aspects of the corporate interest restriction. For instance, the effect of the carried forward limit is that there will be excess debt cap brought forward to a period only and to the extent that there have previously been interest restrictions. So if brought forward excess debt cap reduced the net disallowance for a period to zero, there are likely to be interest reactivations, as in Example 2 below. (However as tax-interest disallowances carried forward are a company rather than a group attribute, this will not happen to the extent that companies with disallowed tax-interest have left the group.)

Compliance requirements

In most cases excess debt cap will only be carried forward from a period in which there is either a restriction or a reactivation and therefore for which a full interest restriction return is submitted. However, it is possible that excess debt will be carried forward in a period where a full interest restriction return is not required. In addition, where the fixed ratio method applies in the period the group may not be required to disclose the adjusted net group-interest expense (ANGIE) in the statement of calculations.

In such circumstances, if the group wishes to make use of excess debt cap in a subsequent period of account, it will need to provide a calculation of the excess debt cap available in the computations backing up the interest restriction return. If the excess debt cap has been growing in amount over a number of periods, this computation may need to reach back over a number of periods of account. But, there will be no need to submit revised interest restriction returns for those periods, because the numbers required to be disclosed on the statement of calculations for those years will not have changed. Where an estimate has been used then this should be disclosed in the return.

Examples

In these examples, the worldwide group draws up consolidated financial statements for period of one year ending on 31 March. There is no period of account straddling 1 April 2018 and first period to which the CIR applies is therefore the year to 31 March 2018. There are inevitably no amounts brought forward to that period.

Example 1

In this example, excess debt cap carried forward from the period of account to 31 March 2018 reduces the disallowances that would otherwise have arisen in the period to 31 March 2019.

In the first period of account considered, the

There are no amounts brought forward

Its aggregate tax-EBITDA is £1,000m

Its aggregate net tax-interest expense is £310m

Its ANGIE (adjusted net group-interest expense) is £320m

Its QNGIE (qualifying net group-interest expense) is £285m (£35m of tax-interest expense on related party debt is excluded)

Its group ratio percentage is 33%

Note that as no amounts were brought forward from an earlier period, the carry forward limit is equal to the total disallowed amount for the period.

In this case the group ratio is not advantageous because QNGIE would then become the limiting factor; it is less than 30% of aggregate tax-EBITDA, whereas ANGIE is greater than this amount.

Accordingly the fixed ratio at 30% of aggregate tax-EBITDA of £1,000m becomes the limiting factor. The total disallowed amount and excess debt cap are then:

In the second period of account, the

There are no changes to the composition of the group and all company accounting period coincide with the worldwide group’s period of account.

Aggregate of disallowed amounts carried forward by group companies, £10m, as above

Excess debt cap brought forward is £10m, as above

Its aggregate tax-EBITDA is £900m

Its aggregate net tax-interest expense is £273m

Its ANGIE (adjusted net group-interest expense) is £265m

Its QNGIE (qualifying net group-interest expense) is £241m (£24m of tax-interest expense on related party debt is excluded)

Its group ratio percentage is 25%

In this year a group ratio election is not beneficial:

This may look complicated, but in reality all that has happened is that £5m of debt cap brought forward has been used up in the period to 31 March 2019. Without the amount brought forward, there would have been a £5m larger disallowance, £8m (£273m minus £265m ANGIE), because the debt cap rather than the fixed ratio would then have been the limiting factor.

Example 2

In this example, excess debt cap carried forward from the period of account to 31 March 2018 reactivates additional disallowed amounts carried forward to be reactivated. There is also a residue of unused interest allowance available for later periods. The example is fairly complicated; a number of processes are in play at the same time.

For the year to 31 March 2018, the position is as in Example 1.

In the year to 31 March 2019, it is now as follows:

There are no changes to the composition of the group and all company accounting period coincide with the worldwide group’s period of account.

Excess debt cap brought forward is £10m, as in Example 1

Aggregate of disallowed amounts carried forward by group companies, £10m, as in Example 1

Its aggregate tax-EBITDA is £900m

Its aggregate net tax-interest expense is £259m

Its ANGIE (adjusted net group-interest expense) is £265m

Its QNGIE (qualifying net group-interest expense) is £241m (£24m of tax-interest expense on related party debt is excluded)

Its group ratio percentage is 25%

In this year the group ratio percentage is less than 30%, so a group ratio election is obviously not beneficial and the level of QNGIE is not relevant.

The position is then as follows:

In the absence of the debt cap brought forward, the interest allowance for the period would have been lower, because the limiting factor would have been ANGIE, £265m, as against 30% of aggregate tax-EBITDA, £270m. There would have been no disallowance in the current year, because the interest allowance would still have exceeded the aggregate net tax-interest expense of £259m.

However the interest reactivation cap would then have been £6m (interest allowance £265m - equal to ANGIE, in the absence of excess debt cap brought forward - minus aggregate net tax-interest expense, £259m) - rather than £11m. Accordingly only £6m of disallowance brought forward could have been reactivated, leaving £4m for UK group companies to carry forward to the next period.

The effect of the brought forward excess debt cap was a follows:

There is no interest restriction in the current year excess with or without the excess debt cap brought forward.

However the excess debt cap brought forward increased the disallowed interest brought forward that can be reactivated by £4m from £6m to £10m and there is still unused interest allowance of £1m available to carry forward to later periods (instead of none). In this way, it is possible for excess debt cap brought forward to a period of account to indirectly increase the interest allowance carried forward.

Accordingly the overall benefit is £5m and the excess debt cap carried forward to the next period of account is now £5m, as against £10m brought forward from the previous period.

Example 3

This examples illustrates excess debt cap arising under the fixed ratio method in one year and the group ratio method in the next.

For the year to 31 March 2018, the position is as in Example 1

In the year to 31 March 2019, it is now as follows:

There are no changes to the composition of the group and all company accounting period coincide with the worldwide group’s period of account.

Excess debt cap brought forward is £10m, as in Example 1

Aggregate of disallowed amounts carried forward by group companies, £10m, as in Example 1

Its aggregate tax-EBITDA is £700m

Its aggregate net tax-interest expense is £300m

Its ANGIE (adjusted net group-interest expense) is £285m

Its QNGIE (qualifying net group-interest expense) is £284m (£1m of tax-interest expense on related party debt is excluded)

Its group ratio percentage is 40%

The position is then as follows:

The key point here is that the excess debt cap is not specific to either the fixed ratio method or the group ratio method. It can be used to increase the debt cap limit in either case, depending on which method the group chooses to use in a particular period.

This example also shows how the legislation allows the excess debt cap to grow cumulatively in cases where a group suffers an interest restriction each year but this is not due to the debt cap limit.

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