HMRC - CFM98660 - Company: Items Of Income To Be Left Out Of Account

TIOPA10/S377, SCH7A/PARAS 68, 69

TIOPA10/S377(2) sets out a default order to be applied in identifying classes of tax-interest that are disallowed. S377(3) then provides flexibility by allowing a company to elect out of the default rule.

In the absence of a valid election out, the default rule applies:

Where amendments arise from an interest restriction return, including a revised return;

Where no interest restriction is submitted, but interest restriction is due; and

Where a determination is made by HMRC under SCH7A/PARA56 or 58.

The application of the default rule ensures that there is certainty of the tax position at the level of the UK group company.

The default order

The default order is as follows:

Tax-interest amounts that, if brought into account (under Part 5 CTA 2009), would be non-trading loan relationships debits, fitting the description of relevant loan relationship debits within TIOPA10/S383.

Tax-interest amounts that, if brought into account (under Part 5 CTA 2009), would be non-trading derivative contract debits, fitting the description of relevant derivative contract debits within TIOPA10/S384.

Tax-interest amounts that, if brought into account (under Part 3 CTA 2009), would be trading loan relationships debits, fitting the description of relevant loan relationship debits within TIOPA10/S383.

Tax-interest amounts that, if brought into account (under Part 3 CTA 2009), would be trading derivative contract debits, fitting the description of relevant derivative contract debits within TIOPA10/S384.

Finally, tax-interest amounts that, if brought into account, would represent the financing cost implicit in finance leases, debt factoring or similar arrangements or service concession arrangements accounted for as a financial liability - condition C in S382.

To put this simply, it is non-trading debits first with loan relationship debits before derivative contract debits, then trading debits again with loan relationship debits before derivative contract debits and finally other amounts included in tax-interest expense.

It should be noted that the category of loan relationship debits is wider than it might appear at first sight because it can include a wide variety of amounts treated by CTA09/PT6 as if they were expenses on loan relationships - CTA09/S477(1). Examples include interest on relevant non-lending relationships CTA09/S479, the funding costs on alternative finance arrangements CTA09/PT6/CH6 and funding costs on {repos} CTA09/PT6/CH10.

On the other hand, TIOPA10/S384 restricts the types of derivative contract debits that are included in tax-interest. For guidance on what is and is not included in tax-interest see CFM95600 et seq.

It should be noted that the approach of disallowing an amount equal to a company’s non-trading loan relationships deficit first, followed by trading amounts second, would not be possible in all cases. For example, a company might have a foreign exchange gain, which is not tax-interest income, partly or completely offset by an accrual of loan interest payable, which is a tax-interest expense. In such circumstances, giving effect to a tax-interest restriction might require transforming a loan relationships deficit into a non-trading profit, or increasing a net non-trading loan relationships profit. It follows that it may be necessary to ‘dig down’ into detail of a company’s tax computations to establish the effect of an allocated restriction.

Electing out

The effect of an election under TIOPA10/S377(3) is to disapply the default order and to enable the company to specify which items of tax-interest the company chooses to leave out of account. Such an election is made and administered at company level. This avoids the need for considerable amounts of detail, company by company, in the group’s interest restriction return. It also avoids the need to amend that return for a decision that might alter the tax position only of a single company in the group.

The election is made in a company tax return for an accounting period (PARA68(b)). Note that a worldwide group period of account may overlap or contain more than one relevant accounting period.

The election is not simply an election to set aside the default order in S377; it also identifies the particular tax-interest amounts that are left out of account. No specific form is set for the election. As a practical matter, the election needs to be clear and certain in effect. It would in many cases be impractical to identify specified items debit by debit. It is sufficient to specify to an extent that is adequate to render the company’s tax position unambiguous. It is not necessary to set out detail that can make no difference to the company’s tax position.

The time limit for making an election (PARA 69(5) to (7)) is the later of:

36 months from the end of the accounting period to which the election relates; and

3 months from the date a relevant interest restriction return was received by an officer of Revenue and Customs.

The company may amend its company tax return within these limits to make an election.

The company must also amend its company tax return to give effect to the election within the same time limit and if it fails to do so, it becomes liable to a penalty of £500 and the procedure described at CFM98640 applies (PARA70A). The penalty is administered in the same way as a penalty for failure to deliver an interest restriction return. As a practical matter, it is anticipated that the making of the election and the amendment of the company tax return to give effect to the election will be performed by the company as a single process.

An election can be revoked in a company tax return for an accounting period within the same time limit as above, and there is nothing to prevent a new election being made.

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