HMRC - OT22002 - Transactions Across The Ring Fence

TIOPA10\S205

TIOPA10\S205 (formerly ICTA88\Sch28AA\para11) makes it clear that the arm’s length standard must apply to all cross-ring fence transactions even when both the parties are UK resident. Furthermore the arm’s length standard applies where the cross-ring fence transaction occurs within a single company as well as where it occurs between separate companies.

This means that where a company’s borrowings finance a mixture of ring fence and non-ring fence assets, the latter should be regarded as if they belonged to a separate business when it comes to considering any restriction to arm’s length terms of the interest deductible against ring fence profits.

Example

Considered as a whole, the above company is not thinly capitalised. However, when the ring fence assets are treated as belonging to a separate business, then that business is entirely financed by debt, and the equity is actually negative.

The application of an arm’s length standard to the separate ring fence business would require the ring fence assets to be funded partly by equity. Accordingly, so far as the claimed ring fence debt exceeds what the company could or would have borrowed on arm’s length terms if it had held only its ring fence assets, the interest should be disallowed against ring fence profits.

The legislation provides a clear remedy against the problems of excessive and unnecessary borrowing and will be considered where the gearing is inappropriate and there are concerns about thin capitalisation.

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