

2006 Pre-Budget Report



**HM Revenue
& Customs**

PBRN 01

6 December 2006

CONTROLLED FOREIGN COMPANIES

Who is likely to be affected?

1. UK resident companies that control foreign companies within the scope of the Controlled Foreign Companies (CFC) tax rules.

General description of the measure

2. Draft legislation for inclusion in the next Finance Bill is being published today that will amend the CFC rules following the recent European Court of Justice judgment in the Cadbury Schweppes case.
3. The changes will relax UK CFC rules by enabling UK companies to apply to HMRC to disregard those profits of their CFCs that arise from genuine economic activity in business establishments in other European Union Member States or certain other states in the European Economic Area (EEA).
4. A highly artificial avoidance scheme will be closed off by abolishing the public quotation exemption in the current rules. CFCs currently claiming the public quotation exemption that are not involved in avoidance will be able to claim other exemptions in the current rules.

Operative date

5. The new rules will have effect on and after 6 December 2006. Where a company's accounting period straddles this date, for the purposes of applying the changes it will be treated as two separate periods, one covering the period before 6 December 2006, and one starting on that date. The repeal of the public quotation test will also have effect on and after 6 December 2006.

Current law and proposed revisions

6. The CFC charge is provided for in section 747(4) of the Income and Corporation Taxes Act 1988 (ICTA). It is calculated by reference to the amount of the chargeable profits of a CFC apportioned to a UK Company under section 747(3). The new rules will enable a UK company to apply for this amount to be reduced, to the extent that it represents the net

economic value created directly by work carried out by individuals working for the CFC in business establishments in other European Union member states, or in other EEA states with which the UK has International Tax Enforcement Arrangements. Companies will have a right of appeal in any circumstance where such an application is refused.

7. Section 748(1)(b) and Part II of Schedule 25 ICTA provide for an Exempt Activities exemption in respect of certain CFCs. The new rules apply a new “effectively managed” condition to CFCs resident in another European Union Member State, or in an EEA state with which the UK has International Tax Enforcement Arrangements. In all other respects, the new rules confirm that the Exempt Activities exemption applies in the same way to all CFCs, whether resident inside or outside the EEA.
8. The public quotation exemption provided for in Section 748(1)(c) ICTA will be repealed.

Further advice

9. If you have any questions about these changes, please contact Mary Sharp on 020 7147 2656. Draft legislation and guidance on these changes is available on the HM Revenue & Customs website at www.hmrc.gov.uk