

Corporate interest restriction – Part I

(Lecture B1233 – 20.05 minutes)

This is an introduction to the rules. They are highly complex, amounting to over 50 pages of legislation.

The Corporate Interest Restriction is the UK's legislation implementing the Organisation for Economic Cooperation and Development (OECD) best-practice recommendations for limiting base erosion and profit shifting by means of excessive tax deductions for financing costs.

The aim of the rules is to restrict deductions for a group's net interest and similar financing costs (tax-interest) from 1 April 2017 onwards to an amount which is commensurate with the activities taxed in the UK, taking account how much the group borrows from third parties.

The rules may restrict groups which borrow in the UK from third parties or intra-group to hold or acquire foreign businesses (which do not form part of the UK tax base), and groups which borrow from their shareholders or other related parties, as in typical private equity structures.

The rules apply mechanically. Most of the information needed is already in tax computations, although certain accounting information may also be needed from the group's financial statements. There is no avoidance or purpose condition for the rules to apply.

They apply after most other tax rules, such as transfer pricing and anti-hybrid rules, but before the loss restriction rules.

The company or group can use one of two methods to calculate its interest allowance for the period.

Fixed ratio amount: (smaller of)

1. 30% x Aggregate UK companies' tax-EBITDA
2. Adjusted (worldwide) net-group interest expense ("ANGIE" - accounting measure)

Group ratio amount (smaller of)

31. Group ratio x aggregate UK companies' tax-EBITDA

$\text{Group ratio} = \frac{\text{Qualifying (worldwide) net-group interest expense ("QNGIE")}}{\text{Group EBITDA (accounting measure)}}$

2. Qualifying (worldwide) net-group interest expense ("QNGIE" – accounting measure)

QNGIE is based on ANGIE but excludes interest expense on borrowings from (non-group) associated companies.

Simple example

A single company which is not part of any group (so the group ratio is irrelevant) has net tax-interest expense of £2,700,000. Its Tax-EBITDA is £9,500,000 and its adjusted net-(group) interest expense is £2,600,000.

How much net tax expense is allowed?

The interest allowance using fixed ratio rule is the smaller of:

- 30% x UK companies' tax-EBITDA i.e. 30% x £9,500,000 = £2,850,000
- Adjusted net-group interest expense £2,600,000

i.e. £2,600,000

Net tax-interest expense is £2,700,000 so £100,000 net-tax interest expense must be disallowed in the period. This is carried forward to try to relieve it in future periods as will be seen later.

Group example (all amounts in £ million)

Aggregate net tax-interest of UK group companies	£50
Aggregate tax-EBITDA of UK group companies	£100
(Worldwide) Group EBITDA	£200
ANGIE	£95
QNGIE	£90

Fixed ratio method - maximum allowable interest is the smaller of:

1. 30% of aggregate UK tax-EBITDA (100m) 30
2. ANGIE 95

i.e. £30 million.

Under this method, (50 – 30) £20 million of the interest would be disallowed.

Group ratio method - Group ratio % = QNGIE (excludes related party interest) ÷ (Worldwide) Group EBITDA

i.e. $90 \div 200 = 45\%$ (note, this ratio is not permitted to exceed 100%)

Maximum allowable interest is the lower of:

1. 45% x aggregate UK tax-EBITDA (100) 45
2. QNGIE 90

i.e. £45 million

Using group ratio gives a higher allowance. Only (50 – 45) £5 million interest disallowed.

Unused capacity

If the net tax-interest expense is less than the interest capacity (fixed or group ratio calculation), the unused capacity is carried forward and can be added to the capacity of future accounting periods for up to 5 years.

In future years, the capacity for those years is used first, then the brought forward amounts can be used on a FIFO basis to increase capacity, if necessary, to claim more relief for the net tax-interest expense of that future period.

Filing a return – abbreviated and full returns

Filing a return is necessary in order to:

- Carry forward interest allowances;
- Make certain elections under the CIR rules;
- Allocate any interest disallowance to specific companies;
- Allocate interest reactivations (which will not be relevant in the first period).

Where applicable, an abbreviated return gives a simple filing option that keeps flexibility to extend to a full return if beneficial.

The de-minimis provides an important threshold when considering what approach to take.

If the total net tax-interest expense across the UK companies in the group is below the £2 million annual de-minimis and won't exceed this level in the next five years, there is unlikely to be any benefit in filing a return.

Abbreviated returns

An abbreviated return may only be made if the group is not subject to a restriction of interest. It must contain:

- The name (and UTR if relevant) of the ultimate parent company of the group;
- A list of the names and UTRs of all companies in the group;
- A statement that there is no disallowance;
- A statement that the return is accurate.

Full returns

A full return must contain the same detail as abbreviated return, plus:

- A statement of calculations, including details of tax-interest and tax-EBITDA figures for all companies subject to UK tax, relevant accounts-based figures and the interest allowance and interest capacity;
- A statement as to whether there is a disallowance and if so detail on how it is allocated;

- A statement as to whether there is a reactivation of interest and if so detail on how it is allocated.

Filing requirements

Once a reporting company is appointed (by election or by HMRC), it will have an obligation to file a return:

- within twelve months of the period end, or
- if later three months from its appointment.

An amended return may be made up to three years from the period end (or five years if replacing an abbreviated return with a full return), or if later three months from the reporting company's appointment.

Contributed by Malcolm Greenbaum