Commission Decision (EU) 2019/1352 of 2 April 2019 on the State aid SA.44896 implemented by the United Kingdom concerning CFC Group Financing Exemption (notified under document C(2019) 2526) (Only the English version is authentic) (Text with EEA relevance)

COMMISSION DECISION (EU) 2019/1352

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on the State aid SA.44896 implemented by the United Kingdom concerning CFC Group Financing Exemption

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(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union, and in particular the first subparagraph of Article 108(2) thereof,

Having regard to the Agreement on the European Economic Area, and in particular Article 62(1)(a) thereof,

Having given notice to the parties concerned to submit their comments pursuant to those provisions[(1)] and having regard to their comments,

Whereas:

1. PROCEDURE

(1) By letter of 26 April 2013, the Commission requested the authorities of the United Kingdom ('UK authorities') to provide information on the reform of its Controlled Foreign Company ('CFC') rules, which had entered into force on 1 January 2013. The UK authorities submitted the information on 14 June 2013 and, following further requests for information[(2)], supplied additional information on 10 April 2014, on 10 July 2014, on 24 July 2015 and on 1 February 2017.

(2) By letter of 26 October 2017, the Commission informed the UK that it had decided to initiate the procedure laid down in Article 108(2) of the Treaty in respect of the group financing exemption provided for in the CFC rules ('the Opening Decision').

(3) On 24 November 2017, the Opening Decision was published in the *Official Journal of the European Union*. In the Opening Decision, the Commission invited interested parties to submit their comments on the Opening Decision.

(4) Following an extension of the deadline for providing comments, the UK authorities submitted their comments on the Opening Decision on 15 January 2018.

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(5) Between 19 December 2017 and 2 January 2018, eight interested parties submitted comments on the Opening Decision. The comments were forwarded to the UK authorities. On 23 February 2018, the UK authorities submitted observations on the comments made by interested parties.

(6) On 7 February 2018, a meeting took place between the Commission services and the UK authorities. Following that meeting, the UK submitted additional comments on 22 March 2018. A further meeting between the Commission services and the UK authorities took place on 31 May 2018, followed by additional comments submitted by the UK authorities on 3 July 2018, and then a further meeting took place on 13 July 2018.

2. DESCRIPTION OF THE SCHEME

2.1. The UK Corporate Tax System and the UK CFC rules

2.1.1. *Introduction and Background*

(7) Under UK corporate tax law, companies are taxed on their profits arising from UK activities and assets. It applies to UK resident companies and to non-resident companies that carry on business in the UK through a UK permanent establishment.

(8) The UK reformed its corporate tax system to align more closely with a territorial corporate tax system[(3)], focusing on taxation of profits from UK activities and assets, rather than the worldwide income of a taxpayer[(4)].

(9) The largely territorial character of the UK corporate tax system means that company profits which arise outside the UK are not generally subject to UK tax. In line with this, the UK distribution exemption rules exempt the profits of overseas companies that are distributed back to the UK. Similarly, the foreign branch exemption rules ensure that the profits attributable to foreign permanent establishments are exempt from UK corporate tax. These features could make it attractive for UK companies to set up a subsidiary (a CFC) in a low-tax jurisdiction and to artificially divert profits from the UK to the CFC. The UK CFC rules aim to protect the UK corporate tax base by removing the tax advantage that arises from these arrangements through the imposition of a CFC charge on the UK resident company controlling the CFC[(5)].

(10) Consequently, while the objective of the UK corporate tax system is to tax profits arising from UK activities and assets, the objective of the UK CFC rules is to protect the UK corporate tax base. It achieves this objective not by levying a general UK tax charge on certain types of profit of low-taxed overseas subsidiaries of UK companies, but by levying a CFC charge at the same rate as the UK corporate tax rate only on those profits of the CFC which have been artificially diverted away from the UK. In this regard, it is important to note that a stated aim of the current CFC regime was to target and impose a charge so that UK activity and profits would be fairly taxed but also that no tax would be levied on profits arising from genuine economic activities of the CFC[(6)]. In view of that aim, the UK authorities chose the current CFC rules over

a regime that would tax all the profits or the entire income stream of low-taxed CFCs as that would 'not be appropriately targeted' at taxing UK activity and UK profit[7].

(11) The current UK CFC regime was enacted by the UK Parliament as part of the Finance Act 2012[8]. The regime is incorporated into the Taxes Acts as Part 9A of the Taxation (International and Other Provisions) Act 2010 (hereafter referred to as 'Part 9A of TIOPA'), which contains 22 Chapters. The current regime applies to accounting periods beginning on or after 1 January 2013[9]. In January 2019, several amendments were introduced (Section 2.3).

(12) In addition to the CFC framework laid down in Part 9A of TIOPA, the UK has published extensive guidance relating to the CFC rules. That guidance includes an introduction to the rules, a general overview, guidance on the application and interpretation of specific rules chapter by chapter, and a series of practical examples[10].

2.1.2. *The current UK CFC regime*

(13) In line with the objective mentioned in recital 10, the current UK CFC rules work by imposing a CFC charge on a UK resident company for some or all of a CFC's profits. The CFC charge is due on a CFC's chargeable profits less the CFC's creditable tax (i.e. the tax paid in the CFC's country of residence). For any accounting period, a CFC's chargeable profits are its assumed taxable total profits that pass through the CFC charge gateway (see recitals 23 to 25)[11]. It is apportioned to all UK resident companies which hold at least a 25 % interest in the CFC (referred to as 'the chargeable entities'). The CFC charge is levied at the same rate as the UK corporation tax rate and charged as if it were an amount of corporation tax charged to the chargeable entity for the relevant corporation tax accounting period.

(14) The CFC charge gateway sets out the circumstances and extent to which a CFC's assumed taxable total profits are chargeable profits.

(15) In line with the aim of the CFC rules — examining whether a CFC earns profits from UK assets or activities that are earned by a company that is neither resident nor has a permanent establishment in the UK — the CFC regime broadly assesses whether profits of a CFC relate to assets and risks that are managed and controlled in the UK and on that basis are considered *artificially diverted*. This requires consideration of whether any of the 'significant people functions' (or 'SPF')[12], relevant to the assumption of risks or to the economic ownership of assets that give rise to the profits of a CFC, are actually undertaken in the UK, so that the company *realising* the profits is different from the company *generating* those profits[13].

(16) According to the consultation, which was carried out by the British authorities before adopting the CFC rules, these CFC rules also sought to comply with Union law by not impinging upon taxpayers' freedom of establishment as well as reflecting the balance required to deliver a regime that protects the UK corporate tax base and that can be applied in practice, keeping administrative and compliance burdens to a minimum.

(17) The UK authorities also sought to increase UK tax competitiveness[14]. This was a stated aim of the CFC rules, which 'together with the reduction in the rate of

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corporation tax to 22 % in 2014 and the introduction of the patent box, (…) are another step towards [the UK Government] aim of creating the most competitive corporate tax system in the G20'[15].

(18) Chapter 2 of Part 9A of TIOPA sets out the steps for determining if a CFC charge is due on (part of) the profits earned by a foreign company once it is established that the foreign company is a CFC. Accordingly, a CFC charge arises if:

— none of the CFC entity level exemptions applies (see recital 19);

— there is a UK 'interest holder', in other words a UK resident company that (together with connected companies) holds an interest of at least 25 % in the CFC; and

— the CFC has 'chargeable profits' as set out in the provisions forming the CFC charge gateway.

(19) The aim to limit the administrative and compliance burdens is reflected in the design of the CFC rules, which focuses on situations objectively posing the highest risk to the UK Treasury. This is achieved by providing for certain upfront exclusions where the risk of profits being artificially diverted is considered low, i.e. where a case-by-case assessment would be likely to reveal either no artificiality or no diversion. These are the so-called entity level exemptions included in Chapters 10 to 14 of Part 9A of TIOPA:

— the e*xempted period exemption* is included in Chapter 10 of Part 9A of TIOPA and contains a temporary (usually 12 month) exemption for CFCs that have come under UK control for the first time;

— the *excluded territories exemption* is included in Chapter 11 of Part 9A of TIOPA and exempts CFCs that pose a foreseeable, low risk of artificial diversion due to their territory of residence and the type of profits earned;

— the *low profits exemption*, a *de minimis* rule, is included in Chapter 12 of Part 9A of TIOPA and exempts CFCs with low levels of profits in an accounting period (generally no more than GBP 500 000, of which no more than GBP 50 000 is non-trading profits);

— the *low profit margin exemption* is included in Chapter 13 of Part 9A of TIOPA and exempts CFCs where profits are no more than 10 per cent of operating expenditure. The exemption relates to CFCs that perform relatively low value added functions;

— the *tax exemption* is included in Chapter 14 of Part 9A of TIOPA and exempts CFCs that pay a normal to high level of effective tax in their territory of residence (at least 75 % of the tax that would have been due if its profits had been subject to UK tax and measured on UK rules).

(20) The entity level exemptions reflect the fact that the majority of foreign subsidiaries will be set up for genuine commercial reasons. In practice, this means that UK companies will in the majority of cases not need to apply the CFC rules beyond satisfying one of the entity exemptions. Therefore, application of the detailed charging provisions forming the CFC charge gateway and the need to identify the chargeable

profits of a CFC is confined to situations where none of the entity level exemptions apply.

(21) If none of the entity level exemptions apply, the UK CFC rules apportion a CFC's 'chargeable profits' to the UK 'interest holder'. These are identified by applying the criteria and conditions laid down in Chapters 3 to 8 of Part 9A of TIOPA, together forming the 'CFC charge gateway'[(16)].

(22) Those Chapters are fundamental to the operation of the CFC regime. They are designed to act as targeted tests with the aim of assessing whether the assumed total profits of the CFC pass through the gateway and consequently become 'chargeable profits'.

(23) The CFC charge gateway starts with an initial filter in Chapter 3 of Part 9A of TIOPA, which contains general tests to establish whether any of the more detailed gateway rules in Chapters 4 to 9 of Part 9A of TIOPA need to be applied at all[(17)].

(24) As regards the specific charging chapters, Chapter 4 of Part 9A of TIOPA ('Chapter 4') is a general provision and applies to all CFCs regardless of the type of profits they earn, except CFCs that exclusively earn property business profits[(18)] or non-trading finance profits ('NTFP'). Chapter 5 of Part 9A of TIOPA ('Chapter 5') in conjunction with Chapter 9 of Part 9A of TIOPA ('Chapter 9') deals with CFCs that earn NTFP. Chapter 6 of Part 9A of TIOPA ('Chapter 6') deals with CFCs earning trading finance profits[(19)].

(25) The CFC charge gateway aims to identify circumstances where there has been artificial diversion of UK profits, which generally means that 'there is a significant mismatch between key business activities undertaken in the UK and the profits arising from those activities which are allocated outside the UK'[(20)]. This is most prominent in Chapter 4[(21)]. Under that Chapter, assumed total profits of a CFC from assets that are legally owned by the CFC and from risks contractually allocated to the CFC become chargeable profits if and to the extent that the management of those assets and risks is exercised from the UK[(22)]. This requires consideration of whether any of the significant people functions, that are relevant to the assumption of risks or to the economic ownership of assets that give rise to the profits of a CFC, are actually undertaken in the UK[(23)]. As such, the proportion of UK SPF to non-UK SPF is an essential criterion in identifying chargeable profits, which is applied not only in the general charging provision (Chapter 4) but also for example in Chapter 5 (NTFP)[(24)].

(26) The UK CFC rules recognise, however, that in the case of finance profits, relying solely on the SPF test may not always provide sufficient protection to the UK tax base. Therefore, Chapters 5 to 9 contain additional tests for NTFP and other types of passive profits. Profits of a CFC may be subject to a CFC charge on the basis of more than one charging chapter, but profits can be subject to a CFC charge only once[(25)].

2.1.3. *CFC charge on Non-Trading Finance Profit*

(27) NTFP includes all finance profits that are not trading finance profits. Trading finance profits are dealt with in Chapter 6. NTFP may include both finance profits