Euro Tax Flash from KPMG's EU Tax Centre

European Commission opens in-depth State aid investigation into UK tax treatment of multinational groups under the CFC regime

State aid – CFC regime – Group Financing Exemption - United Kingdom

On October 26, 2017, the European Commission announced that it was opening an in-depth investigation into the UK Group Financing Exemption scheme which allows certain transactions by multinational groups to be exempt from the otherwise applicable rules on Controlled Foreign Corporations (CFC) which target tax avoidance (see the EU Commission's Press Release). The EU Commission believes that this special exemption may have given an unfair tax advantage to certain UK resident companies, in violation of EU State aid rules, and has decided to initiate a formal investigation procedure in order to validate its preliminary view. The EU Commission will reach a final decision at the end of the formal investigation.

Background

The procedure is one of a series of State aid investigations recently launched by the EU Commission as part of EU initiatives in the areas of tax transparency, tackling harmful tax competition between Member States and tax avoidance, and is the first one focusing on the United Kingdom. The investigation should be seen in light of the EU Commission's on-going examination of the McDonald's (see ETF 264) and GDF Suez (see ETF 302) cases as well as the negative decisions rendered on tax rulings issued by Luxembourg and the Netherlands in October 2015 (see ETF 262), by Belgium in January 2016 (see ETF 271) and more recently by Ireland (see ETF 300) and Luxembourg (see ETF 339).

Preliminary findings

The UK CFC regime aims at preventing UK companies from using a subsidiary located in a low or no tax jurisdiction to avoid taxation in the UK. This is achieved by taxing profits that are considered to be artificially diverted from the UK, by allowing the UK tax authorities to reapportion the profits of certain non-resident subsidiaries to their UK parent company. However, an exception to the UK CFC rules was introduced in 2013 – the Group Financing Exemption – under which certain financing income (e.g. interest payments received on loans) do not have to be allocated to the taxable profits of the UK parent company, provided that such financing income received by the offshore subsidiary derives from another foreign group company.

According to the EU Commission, this exemption creates a difference in taxation between profits derived at the level of the CFC from financing a foreign group company, which will not or only partially be subject to taxation in the UK and other types of income, which will be subject to taxation in the UK under the CFC rules.

The press release outlines the EU Commission’s preliminary opinion that the exemption from the UK CFC regime granted to multinational groups on their financing income may not be in compliance with EU State aid rules and that there are also doubts about whether the exemption is consistent with the overall purpose of the regime.

Next steps

As part of the standard procedure in State aid investigations, the EU Commission will publish a non-confidential version of this preliminary decision. The opening of an in-depth investigation gives interested third parties and the Member States concerned an opportunity to submit comments, which will not prejudge the outcome of the investigation. There is no legal deadline for completing an in-depth investigation and its actual length depends on many factors, including the complexity of the case, the information provided and the level of cooperation from the Member State concerned. The EU Commission will reach a final decision at the end of the formal investigation.

EU Tax Centre comment

Depending on the details of the final decision, interesting parallels may be drawn with the OECD’s work on BEPS Action 3 on Designing Effective Controlled Foreign Company Rules, as well as with the EU Anti-Tax Avoidance Directive (ATAD). In this context, the EU Commission pointed out that the ATAD does not provide exemption provisions such as the Group Financing Exemption scheme under review.

Although not surprising, it should also be noted that the EU Commission considered, in the context of the Brexit negotiations, that as long as the UK remains an EU Member State, EU State aid rules will continue to apply in full.

Should you have any queries, please do not hesitate to contact KPMG’s EU Tax Centre, or, as appropriate, your local KPMG tax advisor.

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