



BDO Seidman, LLP
Accountants and Consultants

Subject:

UK Taxation of Foreign Profits

International Tax Alert

The Tax Practice at **BDO Seidman, LLP** is among the largest tax advisory practices in the United States. With 34 offices and more than 300 independent alliance firm locations nationwide, BDO Seidman has the bench strength and coverage to serve you.

As a Member Firm of **BDO International**, BDO Seidman serves multi-national clients by leveraging a global network of resources comprised of 621 Member Firm offices in 107 countries. BDO International is a worldwide network of public accounting firms, called BDO Member Firms, serving international clients. Each BDO Member Firm is an independent legal entity in its own country.

For more information, please contact:

Jack Frame
BDO Seidman, LLP
330 Madison Ave
New York, NY 10017
Phone: 212-885-8125
jframe@bdo.com

In June 2007, HM Revenue and Customs released a discussion document titled *Taxation of the Foreign Profits of companies*, which includes proposals intended for modernizing and creating a more straightforward regime for taxing foreign profits.

Date/Timing

Due to the discussions generated by the issuance of these proposals, it is unlikely that any new tax legislation will be in effect before 2009.

Affecting

The proposed changes will impact UK entities with foreign shareholdings that receive foreign profits.

Summary

The proposals are wide ranging and include changes for medium and large groups, as follows:

- An exemption from tax for foreign dividends received from shareholdings of 10% or more;
- A new income-based CFC regime;
- Restrictions on interest deductions based on the group's total consolidated external financing costs; and
- Replacement of the Treasury Consent obligations with a real-time reporting requirement.

Summary of Proposals

Taxation of foreign dividends

UK companies are currently taxed on foreign dividends, but where ownership interest exceeds 10% or more, they receive a credit for certain foreign taxes. This is known as a tax credit system. A tax exemption has been proposed for large- and medium-sized businesses (those which have a 10% or more interest in foreign subsidiaries) that receive foreign dividends. Such an exemption should significantly reduce the compliance burden that is associated with the current tax credit system.

In addition, a simplified tax credit system for the taxation of foreign dividends for smaller businesses is proposed.

Proposals which are subject to further consideration include the proposals for the taxation of dividends received from foreign shareholdings of less than 10% as either an exemption system, a full tax credit system or a tax credit system only for withholding taxes (as is currently the case).

New Controlled Foreign Company (CFC) rules

A new Controlled Company (CC) regime targeted at charging additional UK tax on what is termed as the “mobile income” of companies (foreign and UK) that are controlled by UK companies is proposed. These new rules would replace the existing CFC rules. The existing CFC rules seek to counter tax avoidance through the accumulation of income of subsidiaries in low-tax countries. The existing rules are based on a company-by-company basis on an all-or-nothing basis and only apply to foreign subsidiaries.

Mobile income would largely include passive (or investment income) and other income that is considered to lend itself to the artificial location of profits. The income types this would include are: dividends, interest, royalties, rents, other income of a similar nature, certain intra-group service income, sales income derived in dealing in goods for delivery to or from the UK and certain other targeted income. In addition, mobile income would include capital gains that arise from the disposal of assets that give rise to passive income. Capital gains are currently excluded from the existing CFC rules.

There will be exemptions for certain types of income, including genuine active finance income, certain intra-group interest and for income generated from transactions in the same country.

The Controlled Company regime will also apply to UK companies. This is to ensure that the new rules are not seen as discriminatory from an EU law perspective.

It is planned that in general smaller business would be excluded from the new Controlled Company regime.

Changes to the rules concerning tax deductions for interest

It is proposed that the rules for interest deduction are to be restricted as follows:

- (a) Interest claimed by a UK member of a multinational group would be restricted by reference to the group's total consolidated external finance costs.
- (b) The unallowable purpose anti-avoidance rules that can deny a deduction for interest in certain circumstances are to be extended.

The UK Government has indicated that anti-avoidance rules may be required if the mix of allowing an exemption for foreign dividends and interest relief for debt is abused.

Treasury Consents

Currently, certain transactions involving foreign subsidiaries that are controlled by a UK company require advance Treasury Consent before they can be implemented or require post transaction Treasury Notification.

It is now proposed that these Treasury Consent/Notification requirements will be removed and replaced with alternative reporting requirements on which the UK Government is seeking comments.

The information in this newsletter is for general guidance only and is not a substitute for professional advice. The BDO Member Firms accept no responsibility for any actions taken or not taken on the basis of the information in this newsletter.

To ensure compliance with Treasury Department regulations, we wish to inform you that any tax advice that may be contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding tax-related penalties under the Internal Revenue Code or applicable state or local tax or (ii) promoting, marketing or recommending to another party any tax-related penalties under the Internal Revenue Code or applicable state or local tax law provisions or (ii) promoting, marketing or recommending to another party any tax-related matters addressed herein.