



**BDO Seidman, LLP**  
Accountants and Consultants

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## Subject:

### **UK Issues Management Expenses Anti-Avoidance Guidance**

# International Tax Alert

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On July 20, 2007 the U.K. Revenue and Customs (“HMRC”) issued guidance on the new targeted anti-avoidance rule for management expenses for corporation tax purposes introduced by Section 28 of Finance Act 2007, which also amended the existing unallowable purpose rule.

#### **Date/Timing**

Effective for management expenses paid on or after June 20, 2007.

#### **Affecting**

Groups with UK subsidiaries that deliberately and knowingly entered into a scheme to avoid tax.

#### **Background**

For the purposes of Corporation Tax a deduction is allowed under S75 ICTA 88 where a company has incurred expenses of management in respect of managing its investment business. The legislation was introduced in 1915 and remained largely unchanged until 2004 when changes were made to reflect a more modern business climate. Those changes included, among other things, an unallowable purpose rule.

HMRC has commented that since the 2004 changes, various attempts have been made to circumvent the unallowable purpose rule and/or to create contrived expenses that could be deducted as expenses of management under S75 ICTA88. HMRC does not consider that these schemes succeed, but their use has shown that the unallowable purpose rule is not a sufficient deterrent.

Section 28 Finance Act 2007 introduces a targeted anti-avoidance rule (“TAAR”) for management expenses. It also amends the existing unallowable purpose rule, to strengthen the business or commercial purpose part of the test so that similar provisions apply to both the purpose for which investments are held and the purpose for which management expenses are incurred. Both new provisions apply to

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expenses of management paid on or after June 20, 2007, the date the measure was announced.

### **The New Measures**

The unallowable purpose rule has been expanded by Finance Act 2007 so that holding investments for the purposes of avoidance is not a business or commercial purpose of the company and related expenses cannot therefore be expenses of management.

Finance Act 2007 also introduced the TAAR. This does not look at the purposes of holding the investments, rather where a company enters into arrangements where the main or one of the main purposes of the arrangements is to avoid tax, then expenditure incurred will not be expenses of management within the meaning of Section 75.

The new TAAR will apply where the main purpose or one of the main purposes of arrangements is to seek to produce a wholly or partly contrived deduction for management expenses or other tax advantage. It is based upon the principle that relief for expenses of management should only be available where a company has genuinely incurred expenditure in the course of managing its investment business. Where the rule applies, its effect is to disallow relief for expenses of management where companies enter into arrangements where tax avoidance is the main purpose or one of the main purposes of the arrangements.

The HMRC is of the view that the new provisions are unlikely to affect the vast majority of companies, only those that have deliberately and knowingly entered into a scheme to avoid tax. HMRC has issued proposed amendments to the guidance on the new provisions.

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