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WTS Wenham Major
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Update on International Tax in the UK

The UK Government has published a consultation document on the treatment of taxation of foreign dividends received by UK companies and the rules on Controlled Foreign Companies (CFCs). This is likely to be the most important issue in the UK international tax arena for the next few years. It is said that the proposed changes will modernise the domestic corporation tax base, making a further milestone in the Government's objective to maintain a competitive tax business for business in line with many countries in Europe.

The key proposals are:

- An exemption regime for foreign dividends for large and medium sized companies.
- A simplified regime for foreign dividends from small companies.
- A new Controlled Companies regime based on income rather than the 'all or nothing' basis of the current Controlled Foreign Companies regime.
- Retention of the interest rules but with stronger anti-abuse provisions.
- Repeal of the requirement for UK companies to obtain Treasury consent before undertaking certain transactions with foreign subsidiaries.

Summary of Key Proposals

1. Foreign dividends

The new rules propose an exemption regime for foreign dividends for large and medium sized companies from UK tax. Small companies will benefit from simplification of the tax credit rules compared to the existing complex tax regime.

2. Controlled Foreign Companies ("CFC")

The CFC rules have been part of the UK's foreign profits regime since the 1980s and it is proposed that the existing CFC regime would be replaced by a new Controlled Companies regime. The new rules are aimed at preventing the artificial location of profits and will target on passive income such as interest, royalties, rent and dividend from non-qualifying companies, including the types of mobile active income covered by the current CFC rules. Under the new rules small business will be outside the scope by a gateway test.

3. Interest Relief

The Government is proposing a more targeted approach in the form of anti-avoidance measures rather than restricting interest expense where foreign profits are not taxable. These measures would limit abuse of the UK rules for interest relief so that the amount of relief is limited to groups' total consolidated external finance costs. It is further proposed that the existing unallowable purpose rules under the loan relationships and derivative contracts would also be amended.

4. Treasury Consent Rules

The rules will be repealed and replaced with targeted reporting requirements.

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Timing

It is anticipated that the above proposals will come into force in 2009.

What actions need to be taken now?

As a first step, existing business should consider what the new proposals would mean to their business, evaluating the potential tax costs and savings. Potential restructuring is required of all current planning in place mainly in view of any up-string loans bearing in mind that the current legislation will apply for the next two years.

Contact Person:
Ms. Kari Campbell

WTS Wenham Major Ltd.
89 Cornwall Street
Birmingham B3 3BY
Great Britain

Phone: +44 (0) 121 236 1866
Fax: +44 (0) 121 200 1389

E-mail: kcampbell@wenhammajor.co.uk
Homepage: www.wenhammajor.co.uk