



# EU Direct Tax Newsalert

## European Commission announces final State aid decision on financing income exemption within the UK's CFC rules

On 2 April 2019, the European Commission (EC) announced in a press release that it has found that the Group Financing Exemption (GFE) within the UK Controlled Foreign Company (CFC) rules is “partly justified”.

The UK CFC rules are provisions which broadly allow the UK to tax the income of overseas subsidiaries, controlled by a UK corporate parent where that income is regarded as artificially diverted from the UK.

The EC focuses on the two ways in which income might be regarded as related to the UK:

- (1) Where the loans are financed with funds or assets which derive from capital contributions from the UK
- (2) Where lending activities relevant to managing the financing activities are located in the UK

The EC finds that where the GFE provides an exemption for arrangements which fall into the first category above, this is justified since the exemption avoids a complex and burdensome intragroup tra-cing exercise.

However, where the GFE has been applied to arrangements in the second category, the EC considers that the exemption is not justified and instead constitutes unlawful State aid. The conclusions set out in the press release give a result consistent with the application of the rules that have been in place from 1 January 2019 (when changes were introduced in

response to ATAD) and indeed the EC specifically state that the rules applicable from 1 January 2019 no longer give rise to any State aid concerns.

The decision has not yet been published but is expected to follow in the next couple of weeks.

### Background

This formal investigation concerns what is commonly referred to as the “Finance Company Partial Exemption” (described by the EC as the *Group Financing Exemption*).

This exemption was introduced as part of the 2012 revision of the UK CFC rules, effective from 1 January 2013, and means that a business with offshore financing arrangements may, in certain circumstances, be subject to a reduced CFC charge in respect of the finance income (reduced by between 75% and 100%).

The exemption has been applied by a large number of UK multinational companies and foreign companies investing into the UK.

### Next steps

The EC will require the UK Government to determine affected taxpayers and the quantum of tax due. It will be important to understand what approach HMRC will seek to take to implement the decision.

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