

CORPORATE INTEREST RESTRICTION

The corporate interest restriction (CIR) rules set a limit on the amount of interest that UK companies and permanent establishments can deduct for UK corporation tax purposes. The rules were introduced with effect from 1 April 2017 as part of the UK's commitment to the Organisation for Economic Co-operation and Development's Base Erosion and Profit Shifting (BEPS) initiatives.

How does the corporate interest restriction work?

The rules are considered from the point of view of a "worldwide group", which will generally consist of an ultimate parent company and all of its consolidated subsidiaries (although complexities can arise in some circumstances).

Members of the worldwide group that are within UK corporation tax will together be able to deduct aggregate "net tax-interest expense" up to the amount of their "Interest Capacity".

In broad terms, "net tax-interest expense" is calculated as interest costs less interest income (although in some cases a detailed analysis will be required to determine what items are, and are not, included within this figure).

A group's Interest Capacity will never be less than £2 million for a 12 month period, so in many cases UK companies will be able to conclude relatively easily that they are not subject to a restriction in a particular year. In other cases, the group will need to determine whether its Interest Capacity exceeds £2m, and this will be based on its "Interest Allowance" for the year, plus any unused Interest Allowance for previous periods.

By default, the Interest Allowance for a period will be calculated under the "fixed ratio method" as the lower of:

- 30% of the group's aggregate tax-EBITDA of companies within the scope of corporation tax, or
- The fixed ratio debt cap (essentially the worldwide group's net external interest expense).

A company's "tax EBITDA" will be based on its taxable profits, but will specifically not include adjustments for research and development, other tax reliefs, interest capital allowances, and deductions in respect of intangible fixed assets.

As an alternative to using the "fixed ratio method", the Interest Allowance can be calculated under the "group ratio method" as the lower of:

- The "group ratio percentage" of the tax-EBITDA of companies within the scope of corporation tax, or
- The group ratio debt cap (essentially the worldwide group's net external interest expense but with some exceptions).

The "group ratio percentage" is essentially the group's worldwide net interest expense (with some exceptions), divided by the group-wide EBITDA for the period.

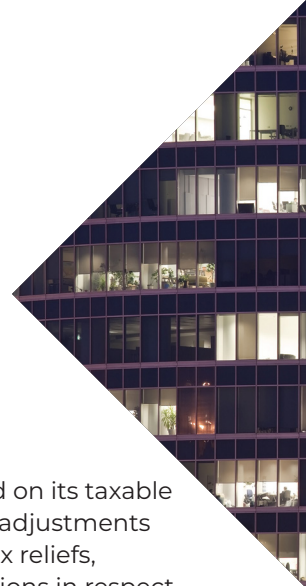
Where the aggregate "net tax-interest expense" of group companies within UK corporation tax exceeds the group's Interest Capacity for the period, the excess will not be allowable as a deduction for the group.

How is any disallowed interest expense dealt with?

Within the group, any disallowance that is required under the rules can be allocated between members of the group that are subject to UK corporation tax in the way in which they chose. This is subject to the fact that the disallowance allocated to any individual group member cannot exceed the net interest expense of that group member.

Any disallowed amounts will be carried forward within the relevant company indefinitely.

If in a future accounting period the group has excess Interest Capacity, these brought forward amounts will be reactivated and treated as tax interest expenses in the period.



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What are the compliance obligations?

Companies and groups can appoint a reporting company, which will be responsible for submitting any CIR return on behalf of the group. HMRC must be notified electronically when a reporting company has been appointed.

Where a group's net interest expense is not subject to a restriction, a reporting company does not need to be appointed and a CIR return does not need to be submitted. However, a group may still decide to appoint a reporting company, which can then submit an abbreviated CIR return on behalf of the group. This approach may be appropriate if the group has unused Interest Allowance which it may wish to use in the future.

Where a group's net interest expense is subject to a restriction for a period, a reporting company must be appointed (unless it is already in place from a previous year) and it must submit a full CIR return. This must be submitted electronically within 12 months of the end of the period. A CIR return contains details of the restriction (and the way in which it was calculated), as well as certain specific details in respect of the various companies within the worldwide group.

Next steps?

This flyer is intended to provide a high level summary of the CIR rules.

The detailed rules are complex and specific analysis and advice is likely to be required to ensure the rules are applied correctly in individual cases. In addition, other provisions may need to be considered in determining the tax treatment of interest and similar expenses (including the anti-hybrid rules and the transfer pricing rules).

We at Moore Kingston Smith can provide bespoke advice on your financing arrangements and their implications, and we can assist you with any associated compliance obligations.

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