



TAX  
FACULTY



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The Rt Hon Jane Kennedy MP PC  
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Dear Ms Kennedy

### **Taxation of Foreign Profits**

We are aware that HM Treasury has been soliciting views on how best to proceed with its Consultation on the Taxation of Foreign Profits, and so we are writing to set out our views.

We consider there is great advantage in engaging in a wider strategic discussion about the UK corporate tax system, which should be broadened beyond the current focus on foreign profits. The Multinational Forum which you chair will be a valuable contributor to that debate. However, it is clear that there are some current imperatives which lead us to recommend that the Government's reform 'package' be split into two parts.

Accordingly, we suggest that the Government should introduce, with effect from 1 April 2009, the long-awaited dividend exemption, together with, if considered absolutely necessary, the worldwide interest restrictions included in the June 2007 Discussion Document, as developed during the consultation process. This would bring:

- A dividend exemption for shareholdings over 10% which, in our view, would be largely self-financing through repatriation of cash to the UK;
- A dividend exemption for portfolio holdings, which is one of the possible outcomes required by the judgment of the European Court of Justice in December 2006, in the *Franked Investment Income* group litigation order; and
- A limited cap on UK deductions for interest expense, by reference to total worldwide external financing costs.

We recommend that the Government do not introduce a dividend exemption with transitional restrictions, as this would limit the benefit to the UK of repatriation and cause major compliance problems.

We further recommend that, as a separate exercise, the Government conduct a wide-ranging Consultation in respect of the UK tax base – and announce this as soon as possible.

We believe it is important that such a Consultation is not simply limited to the rules in respect of foreign profits, for three reasons of principle:

- Firstly, it is important to ensure that any tax reforms take account of the interests of all UK businesses and not just those carrying on international activities.
- Secondly, there are multiple ways of protecting the UK tax base. A difficulty with the discussions to date is that they have focused exclusively on a single area, being the taxation of overseas passive income. We would like to encourage the Government to consider a wider range of options and seek input from business and practitioners.
- Thirdly, we consider that the UK tax system needs to recognise the economic value to the UK of UK-headquartered activities, without acting to the detriment of other forms of ownership. Again, the current discussions appear not to have reflected this.

In addition, this Consultation should be broadened to cover the position of groups which carry on business through branches. Consideration of this important business form – which is especially important to the sectors which contribute most corporation tax (banking, insurance and oil and gas) - had been left out of the original debate.

We also hope that a wider consultation could consider potential incentives to encourage multinationals to conduct business in the UK. Other EU Member States have introduced incentives successfully – and seen economic benefits from them.

We hope that this wide-ranging consultation could be conducted in an open manner with business, economists and professional advisers, including the CIOT. We regret that the discussions following the June 2007 document largely ignored the important work done by the CIOT, other professional bodies and firms of advisers. It is also important that there is some discussion about the short and medium term financial impacts of reform for the Exchequer and for business.

Yours sincerely



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