Corporate Interest Restriction

How the new rules impact the energy industry

KPMG Power and Utilities Tax – February 2018

Highly geared power and utilities companies may face higher tax charges as a result of the new Corporate Interest Restriction rules in force from 1 April 2017. This note sets out how KPMG's tax specialists can help companies work through and understand the impact of the changes.

How can KPMG help?

— Determine the most appropriate of the three methods available to claim interest relief being the Fixed Ratio Method ('FRM'), Group Ratio Method ('GRM') or the Public Benefit Infrastructure Exemption ('PBIE').

— Establish whether groups qualify for the Public Benefit Infrastructure Exemption, whether it would be beneficial to elect for it to apply, and what permissible restructuring may be necessary to qualify.

— Consider if interest on pre-May 2016 shareholder loans funding Public Benefit Infrastructure is exempted.

— Apply for non-statutory business clearances from HMRC on specific fact patterns to gain clarity.

— Advise on financing documents and guarantee arrangements for new investments and loans and modelling the impact of raising finance.

Key features

De minimis exemption	For all groups of companies, the first £2 million of interest is always deductible.
Fixed ratio method	The FRM will limit the amount of deductible interest to 30% of UK "tax EBITDA".
Group ratio method	Enables a group to replace 30% fixed ratio with the group's interest to EBITDA ratio. This method is beneficial for highly geared groups but the replacement ratio excludes related party gearing and therefore could restrict UK tax relief on interest to third party borrowing costs.
Debt cap	A debt cap can also apply under both the FRM and GRM, such that, broadly, the interest expense cannot exceed the interest expense of the worldwide group for the period.
Carry forward	Interest above the deductible limits can be carried forward indefinitely to future periods. Where there is more UK tax-EBITDA capacity than there is interest expense, the excess capacity can be carried forward for up to five years. Excess debt cap capacity can only be utilised in the following period.

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Key terms

- The legislation uses an accounting definition of ‘**group**’.
- **Interest** is broadly anything accounted for as interest, e.g. finance lease interest. The rules will apply to the net interest expense in the accounts after the application of all other UK legislation that may restrict interest relief (e.g. transfer pricing).
- **Fixed ratio method** is the lower of 30% of tax EBITDA and adjusted net group interest expense plus net tax-interest income of the group.
- **EBITDA** is earnings before interest, tax, depreciation and amortisation. The fixed ratio rule will apply to ‘tax-EBITDA’, which is accounting EBITDA adjusted for non-taxable and non-deductible items.
- **Third party debt** does not generally include a loan from a shareholder, even a minority shareholder where there is a consortium of investors

Group ratio method

While many groups will ultimately feel that their wider group has a good level of non-related party interest, the practicalities are leading many to find that they need to rely on other means to ensure that their interest costs are not restricted.

In practice, for multinational groups the group ratio method may give rise to the requirement to prepare additional calculations and a level of complexity, limiting the extent on which it can provide a benefit.

Public Benefit Infrastructure Exemption

There is a Public Benefit Infrastructure Exemption (‘PBIE’) for companies falling within the definition of a ‘qualifying infrastructure company’. A qualifying company must elect into the PBIE. The election is irrevocable for five years.

To qualify, a company must satisfy tests on the nature of the infrastructure and the income earned from it.

The asset must either be provided to a public authority, or its use may be regulated by an ‘infrastructure authority’ (of which the legislation contains a list).

HMRC recognise that some groups may need to reorganise certain aspects of their holding structures in order to access the exemption as intended.

An election for the PBIE must be made by 31 March 2018.

How does the PBIE help?

Under the PBIE, a qualifying infrastructure company’s interest payable to unrelated parties is treated as outside the scope of the corporate interest restriction (‘CIR’) rules. This exemption would not generally apply to loans from shareholders.

There are grandfathering provisions in place so that, for most Private Finance Initiatives (‘PFI’) and similar companies with publicly procured / sponsored revenue streams, interest on all loans made before 13 May 2016 will be outside the scope of the CIR rules, including loans from shareholders.

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