

The trading income exemption

The trading exemption in ss 371HE–371HK is not as userfriendly as one would hope.

Ideally this would be a straightforward exemption for genuine overseas trading operations. However there may be difficulties in practice with satisfying the 'management expenditure condition'. The current 'effectively managed' overseas test is somewhat different.

The key point to watch is that 'related management expenditure' is not all the management expenditure relating to the CFC's business. It is limited to expenditure on higher level, more strategic, management functions.

Groups with centralised UK management of their overseas

operations will currently satisfy the 'effectively managed' test (which leaves room for some UK management) but may not satisfy this condition.

The new test is also at odds with the more relaxed interim exemption for trading *companies* introduced in FA 2011 which in most circumstances has no management-type condition at all, so in this regard the new exemption is much more restrictive.

Strangely, if such a group was to restructure to move more of these higher level management functions from the UK to the overseas jurisdiction to satisfy this condition the breadth of the targeted anti-avoidance rule in s 371K would then deny the exemption!

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Also it will often be difficult to be sure that the condition is satisfied. You have to identify the assets and risks and then identify the expenditure on staff who carry on the related higher level management. You then have to perform a calculation (annually). This exemption suffers from the same practical weaknesses as the gateway.

One would hope that this condition (and the gateway) will be made more user-friendly in the Finance Bill. If not groups that find themselves tripped up can always consider an EU law challenge.

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