



**Restrictions on losses and other amounts surrenderable as
group relief by non-UK resident companies
(updated for Finance Bill 2013)**

Technical Note
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Introduction

This Technical Note sets out the detail of a legislative change to section 107 Corporation Tax Act 2010 (CTA 2010). It is an updated version of the Technical Note published on 11th December 2012. Section 107 CTA 2010 restricts the losses and other amounts that can be surrendered as group relief for corporation tax purposes in the UK by a non-UK resident company carrying on a trade in the UK through a permanent establishment (PE).

Currently, non-UK resident companies resident in the European Economic Area (EEA) are subject to the same rules as non-EEA resident companies.

From 1 April 2013, a different restriction will apply for EEA resident companies, based on whether the losses attributable to their UK PEs are actually relieved in another country, rather than on whether they could potentially be relieved in another country.

Chapter 1

Background

- 1.1. The recent decision of the Court of Justice of the European Union (CJEU) in the case of *Philips Electronics UK Ltd* (C-18/11) ruled that subsection 403D(1)(c) ICTA 1988 (now subsections 107(5) and (6) CTA 2010) was not compatible with EU law.
- 1.2. As a result, the Government announced draft legislation on 11 December 2012 that amends section 107 CTA 2010.
- 1.3. The legislation included in Finance Bill is unchanged from the draft published on 11 December 2012.

Policy aims

- 1.4. The Government has decided to amend the group relief rules in order to conform to the CJEU ruling in *Philips Electronics UK Ltd* and to ensure that losses are not relieved twice, once as group relief in the UK and then again in another country.
- 1.5. Currently, non-UK resident companies resident in the EEA are subject to the same rules as non-EEA resident companies. The legislation will be amended for EEA resident companies and will remain unchanged for non-EEA resident companies.
- 1.6. The amendments will prevent a non-UK resident company that is resident in the EEA from surrendering group relief for a loss or other amount attributable to its UK PE to the extent that it is relieved against the non-UK profits of any person in any period. Where an amount that has been surrendered as group relief is later used against non-UK profits, then the benefit of the UK group relief will be withdrawn to the extent that the amount has been relieved elsewhere.

Chapter 2

Current rules

- 2.1. From 1 April 2000, a non-UK resident company carrying on a trade in the UK through a PE can participate in group relief. The rules which provide for this are in Section 107 CTA 2010, which allow a non-UK resident company carrying on a trade in the UK through a PE to surrender a loss or other amount as group relief where three conditions are met.
- 2.2. The first condition (A) is that the loss or other amount is attributable to activities of the company's UK PE in respect of which the company is within the charge to corporation tax. The second condition (B) is that the loss or other amount is not attributable to activities of the company that are exempted from taxation under a double taxation treaty. These two conditions ensure that group relief is available only for amounts that would have been taxable in the UK had the result been positive.
- 2.3. The third condition (C) is the successor to the provision considered in *Philips Electronics UK Ltd*. It is that the loss or other amount (or any amount brought into account in calculating it) does not correspond to, and is not represented in, an amount that is deductible or otherwise allowable for tax purposes against non-UK profits of any person in any period.
- 2.4. Condition C is an 'all or nothing' test, so that if any part of the loss or other amount attributable to the non-UK resident company's UK PE is deductible or otherwise allowable against non-UK profits then none of that loss or other amount can be surrendered as group relief.
- 2.5. Condition C uses the terms "deductible" and "allowable". It is not enough for there to have been no deduction or relief in foreign tax computations for the period that the loss or other amount relates to. In general, the carry forward of losses in the foreign jurisdiction for relief against future profits will also prevent a group relief surrender.

Amendments

- 2.6. A draft clause to implement the policy change is set out in Chapter 3. This clause amends the operation of section 107 CTA 2010.
- 2.7. Subsection (2) provides that where the surrendering company is established in the EEA then (as before) it may surrender losses and other amounts that meet Conditions A and B, but they no longer need to meet Condition C. Instead these losses are subject to a new restriction, set out at subsection (4) of this clause.
- 2.8. The effect of subsection (3) is that for a non-UK resident company that is not established in the EEA, section 107 remains unchanged.
- 2.9. Subsection (4) inserts a new restriction for a company established in the EEA. It may not surrender losses and other amounts that meet conditions A and B if and to the extent that they are deducted from, or allowed against, non-UK profits of any person in any period.
- 2.10. Subsections (6) to (8) provide that this amendment applies to losses arising on or after 1 April 2013. Where an apportionment is needed to work out the losses that arise from this date, companies should use a time apportionment basis unless that produces an unjust or unreasonable result.

Chapter 3

Draft legislation

Loss relief surrenderable by non-UK resident established in EEA state

(1) Section 107 of CTA 2010 (surrender of losses etc) is amended as follows.

(2) After subsection (1) insert –

“(1A) If the surrendering company is established in an EEA state (within the meaning of section 134A), it may surrender a loss or other amount under this Chapter only so far as conditions A and B are met. Subsection (6A) imposes restrictions on a surrender under this subsection.”

(3) In subsection (2) for “The” substitute “In any other case, the”.

(4) After subsection (6) insert –

“(6A) A loss or other amount may not be surrendered by virtue of subsection (1A) if and to the extent that it, or any amount brought into account in calculating it, corresponds to, or is represented in, amounts within subsection (6B).

(6B) An amount is within this subsection if, for the purposes of non-UK tax chargeable under the law of a territory, the amount is (in any period) deducted from or otherwise allowed against non-UK profits of any person.”

(5) In subsection (7), after “subsection (6)” insert “or (6B)”.

(6) The amendments made by this section have effect in relation to accounting periods beginning on or after 1 April 2013.

(7) But for this purpose an accounting period beginning before, and ending on or after, 1 April 2013 is to be treated as if so much of the period as falls before that date, and so much of the period as falls on or after that date, were separate accounting periods.

(8) An apportionment for the purposes of subsection (7) must be made in accordance with section 1172 of CTA 2010 (time basis) or, if that method produces a result that is unjust or unreasonable, on a just and reasonable basis.

Chapter 4

Interaction with existing legislation

- 4.1. The total amount available for surrender as group relief for an EEA resident company is determined principally by reference to section 99 and section 107 CTA 2010.
- 4.2. The new restriction for a company established in the EEA in section 107 CTA 2010 operates on the basis of whether losses and other amounts are deducted from, or otherwise allowed against, non-UK profits in any period.
- 4.3. Where losses and other amounts are used against non-UK profits after a notice of consent to surrender has been made, this will reduce the total amount available for surrender. As a result the surrendering company may need to take action in order to reduce the losses and other amounts it has surrendered.
- 4.4. Existing provisions at paragraph 75 Schedule 18 Finance Act 1998 (FA 1998) will require the surrendering company to withdraw (and allow it to replace) existing consents to surrender if the amount surrendered exceeds the total amount available for surrender. The following example¹ illustrates how these provisions would operate together.

Year 1

A Netherlands resident company (Company A) is trading through a PE in the UK. For UK tax purposes Company A's PE makes a trading loss of £1m (all of which would have been taxable in the UK had the result been positive). For Netherlands tax purposes Company A makes a loss of €5m (€2m of this loss is attributable to the PE). Company A is not part of a Dutch fiscal unity, so its losses may not be set against the profits of another Netherlands company.

The total amount available for surrender is determined under Part 5 of CTA 2010. Under section 99 CTA 2010 and section 107 CTA 2010 the total amount available for surrender for Company A is £1m. Company A surrenders this in full to a fellow group company resident in the UK (Company B).

Year 2

For Netherlands tax purposes Company A makes a profit of €20m (this includes €3m of losses attributable to the PE).

For UK tax purposes Company A's PE makes a trading loss of £2m (all of which would have been taxable in the UK had the result been positive). Company A has deducted all the losses attributable to its UK PE from non-UK profits, as they are taken into account in arriving at Company A's profits of €20m. Under section 99 CTA 2010 and section 107 CTA 2010 the total amount available for surrender in Year 2 is therefore £nil so Company A cannot make a group relief surrender for Year 2.

Company A sets its total loss from Year 1 against its €20m profits in Year 2, reducing its chargeable profits for Netherlands tax purposes to €15m. Company A has deducted all the Year 1 losses attributable to its UK PE from non-UK profits.

¹ This example is purely illustrative in that it assumes that the Netherlands rules allow UK PE losses to be used to reduce Dutch profits, even though the Netherlands rules, from 1 January 2012, do not allow this.

Under section 99 CTA 2010 and section 107 CTA 2010 the total amount available for surrender in Year 1 is now £nil.

The use of this Year 1 loss is a 'triggering event' for paragraph 75 Schedule 18 FA 1998 to apply as the total amount available for surrender in Year 1 has now been reduced to below the £1m surrendered. Company A is required to withdraw its notice of consent to surrender to Company B (notifying both Company B and HMRC). Company B is required to amend its company tax return to reflect this.

- 4.5. If Company B cannot (or fails to) amend its return for Year 1 then HMRC can issue the claimant with an assessment under paragraph 76 Schedule 18 FA 1998 to recover tax arising from the excessive group relief. If necessary, HMRC can recover any unpaid tax from another company that has had the benefit of group relief from that surrendering company for the same period under paragraph 75A Schedule 18 FA 1998.

Chapter 5

Calculation

- 5.1. The current Condition C in section 107 CTA 2010 (which will continue to apply to non-EEA resident companies) operates in an ‘all or nothing’ way, so that if any part of the losses or other amounts attributable to the non-UK resident company’s UK PE are deductible or allowable against non-UK profits then none may be surrendered as group relief.
- 5.2. The new restriction for EEA resident companies to be inserted into section 107 CTA 2010 provides that if relief is given against non-UK profits for part of the loss or other amount, then the remaining unused part will be available for surrender as group relief.
- 5.3. Where losses and other amounts attributable to a UK PE are relieved against non-UK profits they will be calculated in accordance with the tax rules of that other territory. There will be differences between the calculation for UK tax purposes and the calculation in another jurisdiction, so the calculation of the amounts that remain unused may not be straightforward.
- 5.4. The draft legislation is silent on the matter of how such amounts should be calculated, recognising that what is appropriate in one case may not be appropriate in another; a just and reasonable basis is therefore implied.
- 5.5. The maximum amount available for surrender as group relief is the losses, etc, attributable to the UK PE for UK tax purposes. Any just and reasonable calculation must adhere to this principle.
- 5.6. Identifying whether losses and other amounts attributable to a UK PE are relieved against non-UK profits must be determined by reference to the rules of that territory.
- 5.7. There will be cases in which the rules of that territory do not identify which losses have been used; where this is the case, the following examples may provide assistance.

(1) A non-resident company uses losses brought forward against its non-UK profits from a number of earlier periods. The law of the relevant territory does not specify which year’s losses are used. It may be reasonable to assume that its losses from earlier years are used before the losses of subsequent years (on a first in, first out basis).

- *Where the loss for a particular year is used on this basis, but none of that loss is attributable to the UK PE, then it is reasonable to consider that UK PE losses have not been used against non-UK profits and that no group relief restriction is necessary.*
- *Where the loss for a particular year is used on this basis, and that year’s loss is partially attributable to the UK PE then it may be reasonable to consider that the UK PE loss for that year is used on a proportionate basis, whereby if 80% of the year’s loss is attributable to the UK PE then 80% of the loss that has been used against later non-UK profits is assumed to be attributable to the UK PE.*

(2) A non-resident company is part of a tax consolidation regime and there are insufficient profits in the consolidation to use all losses arising in that year. The law of the relevant territory does not specify which entity's losses are used. It may be reasonable to assume that each entity's losses are used on a proportionate basis, whereby if an analysis of the losses demonstrates that the UK PE losses constitute 60% of the total losses in the consolidation in that year, then 60% of the losses used against that year's consolidated profits is assumed to be from the UK PE.

In contrast, if the consolidation had achieved a net profit in the year against which it used brought forward losses, then it may be reasonable to assume that the losses that are used against non-UK profits are used on a first in, first out basis to determine the periods from which the losses were used, followed by a proportionate method to determine the proportion of those losses that were attributable to the UK PE.

Annex A

Tax impact assessment

Exchequer impact (£m)	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
	nil	nil	nil	nil	nil	nil
	This measure is not expected to have an Exchequer impact. The Office for Budget Responsibility has included these numbers in its forecast.					
Economic impact	This is not expected to have any significant macroeconomic impacts.					
Impact on individuals and households	There is no impact on individuals because this measure only affects EEA resident companies with loss-making UK PEs that are part of a UK group for group relief purposes.					
Equalities impacts	No equalities impacts have been identified because this measure only affects EEA resident companies with loss-making UK PEs that are part of a UK group for group relief purposes.					
Impact on business including civil society organisations	<p>This measure is expected to have a negligible impact on businesses and civil society organisations. The number of companies that will be affected by this measure is relatively small; these businesses will incur a negligible additional annual administrative burden as they will need to monitor whether losses surrendered as group relief in the UK are used in another territory in a later period.</p> <p>This negligible additional burden to businesses will be considerably outweighed by the positive impacts of the measure that provides increased opportunities for EEA resident companies to surrender the losses from their UK PEs as group relief.</p>					
Operational impact (£m) (HMRC or other)	The additional costs for HM Revenue & Customs in implementing this measure are anticipated to be negligible.					
Other impacts	<p><u>Small firms impact test</u>: it is expected that small businesses will not be affected by this measure.</p> <p>Other impacts have been considered and none have been identified.</p>					