

## EXPLANATORY NOTE

### RESTRICTIONS APPLYING TO CERTAIN DEDUCTIONS MADE BY BANKING COMPANIES

#### SUMMARY

1. Clause [X] and Schedule [A] will restrict the proportion of a banking company's taxable profits arising after 1 April 2015 that can be offset by certain carried forward reliefs to 50 percent. The restriction will apply to relief by carried-forward trading losses, non-trading loan relationship deficits, and management expenses that have accrued by 1 April 2015. This will ensure that a proportion of tax is paid by banking companies that are profitable for an accounting period, even where there are substantial carried forward losses.
2. The new Part includes an anti-avoidance rule that applies from 1 April 2015, but to arrangements entered into from 3 December 2014. The anti-forestalling rule within the Schedule applies from 3 December 2014 and to arrangements entered from that date.

#### DETAILS OF THE CLAUSE

3. Clause [X] introduces Schedule [A], which is made up of three Parts:
  - Part 1 inserts a new Part 7A into CTA 10,
  - Part 2 makes consequential amendments to other parts of the Taxes Acts, and
  - Part 3 introduces anti-forestalling provisions and deals with commencement.

#### *Part 1: New Part 7A CTA 2010*

4. New section 269A gives an overview of the part.
5. New sections 269B to 269E give the definition of a 'banking company' and related terms in order to establish which companies are included in the scope of the Part.
6. New subsections 269F(1) and (2) create a restriction on the amount of pre-1 April 2015 carried forward trading losses that a banking company can use in calculating its taxable total profits for an accounting period. The company can only use enough of these losses to cover 50 percent of the 'relevant trading profits' as defined by new section 269I.
7. New subsection 269F(3) dis-applies the restriction where the company has no profits against which pre-2015 carried forward trading losses could be set.

8. New subsection 269F(4) defines pre-2015 carried forward trading losses as trading losses carried-forward in accounting periods ending before 1 April 2015, including notional periods ending 1 April 2015 as a consequence of paragraph 6 of this Schedule.
9. New subsections 269G(1) and (2) create a restriction on the amount of pre-2015 carried forward non-trading deficit that a banking company can use in calculating its taxable total profits for an accounting period. The company can only use enough of these deficits to cover 50 percent of the 'relevant non-trading profits' as defined by new section 269J.
10. New subsection 269G(3) dis-applies the restriction where the company has no profits against which pre-2015 carried forward non-trading deficit could be set.
11. New subsection 269G(4) defines pre-2015 carried forward non-trading deficit as non-trading deficit carried-forward in accounting periods ending before 1 April 2015, including notional periods ending 1 April 2015 as a consequence of paragraph 6 of this Schedule.
12. New subsections 269H(1) and (2) create a restriction on the amount of pre-2015 carried forward management expenses that a banking company can use in calculating its taxable total profits for an accounting period.
13. New subsection 269H(3) dis-applies the restriction where the company has no profits against which pre-2015 carried forward management expenses could be set.
14. New subsections 269H(4) to (6) define pre-2015 carried forward management expenses as management expenses carried-forward in accounting periods ending before 1 April 2015, including notional periods ending 1 April 2015 as a consequence of paragraph 6 of this Schedule.
15. New subsection 269H(7) establishes that the amount of pre-2015 management expenses that can be allowed is the balance of 50 percent of the relevant profits, after reduction by pre-2015 carried forward trading losses and pre-2015 carried forward non-trading deficits.
16. New subsection 269I(1) establishes how relevant trading profits, relevant non-trading profits, and relevant profits are calculated.
17. New subsection 269I(2) lists the reliefs that should not be included in the calculation of relevant profits. Reliefs carried back from later periods are included, so these can in effect be claimed against the 50 percent of profits remaining.
18. New section 269J excludes from the restriction any carried forward reliefs that arose in an accounting period ending before the accounting period in which a company began to carry on relevant regulated activity. Where a company begins to carry on relevant regulated activity part way through an accounting period, there is no requirement to apportion the period for these purposes. Relevant regulated activity is defined in new section 269D, it is not the same as the full definition of a banking company for the purposes of the Part.

Relevant regulated activity includes activity of a type that would be regulated under the Financial Services and Markets Act 2000 even if the company carrying on the activity is not regulated under that Act.

19. New subsections 269K(1) to (3) remove relevant carried forward losses from the restriction where they have arisen in the first five years of a company beginning to undertake relevant regulated activity. This ensures that expenses made during the start-up period of entering the banking sector are not subject to the restriction.
20. New subsection 269K(4) ensures that reliefs generated in the start-up period are taken to have been used before any reliefs that arose after the start-up period, so that (unrestricted) start-up losses are taken to have been used before (restricted) relief that arose after the start-up period when establishing what relevant carried forward losses remain to a company at 1 April 2015.
21. New subsection 269K(5) and (6) give rules for apportioning a company's accounting period that is split by the end of the five year start-up period.
22. New subsection 269K(7) brings the three reliefs affected by the Part into the definition of 'relevant carried forward loss' for this section.
23. New subsection 269K(8) directs to the following section for the definition of start-up period.
24. New subsection 269L(1) defines the start-up period as five years from the day on which a company first undertook relevant regulated activity. This period may be curtailed when a company changes groups. A company is tested on when it begins to carry on relevant regulated activity (defined in new section 269D) instead of when it became a banking company for the purposes of this Part (see the comments on new section 269J).
25. New subsections 269L(2) and (3) applies where the company is a member of a group which contains other members who began to carry on relevant regulated activities not more than five years before the company. The start-up period for that company ends when the five years ends for the earliest group member.
26. New subsection 269L(4) applies where the company is a member of the group which contains other members who began to carry on relevant regulated activities more than five years before the company; the company has no start-up period.
27. New subsections 269L(5) and (6) apply where the company becomes a member of a different group during its start-up period. If the company represents a significant proportion of the relevant regulated activity of the group it joins then its start-up period will not change; if it does not then it will inherit the earliest start date in the group (see subsections (2) to (4)), which may mean the company has no start-up period.

28. New subsections 269L(7) and (8) apply where one or more companies undertaking relevant regulated activity join the group the company with a start-up period is a member of. If the new companies represent a significant proportion of the relevant regulated activity of the group and they have an earlier start date, then the company will inherit that start date (see subsections (2) to (4)), which may mean the company has no start-up period.

29. New subsection 269L(9) includes joining a partnership in references to joining a group within the section.

30. New subsection 269L(10) refers to new section 269O for a definition of first beginning to carry on relevant regulated activity.

31. New subsections 269M(1) to (5) outlines the conditions for the targeted anti-avoidance rule to apply. There are three conditions: for an arrangement to be within the rule:

- The arrangement creates profits in a company with restricted reliefs that could otherwise be used against those profits;
- As a result of the arrangement the company, or that company taken with one connected with it, would secure a tax benefit; and
- The value of the tax advantage forms more than half of the total economic benefit of the arrangements to the company, or the company taken together with companies connected with it.

32. New subsection 269M(6) removes profits from relevant profits where they arise from arrangements that meet the conditions. This effectively denies use of any of the pre-2015 restricted reliefs against profits of the arrangements.

33. New subsection 269M(7) gives definitions for the section.

34. New section 269N defines when a company first begins carrying on relevant regulated activity as the first time it has undertaken this activity. Where the company is a successor to the relevant regulated activity of an older company, the successor inherits the start date of the predecessor company; this also applies where the predecessor was a building society.

35. New section 269O defines group for the purposes of the Part as the group under international accounting standards or, where appropriate, United States generally accepted accounting practice. The term group is not relied upon for the anti-avoidance rule in new section 269M, which relies on a test of connection (the term connected read in accordance with section 1122 of CTA 2010).

36. New section 269P defines various terms for the Part.

37. New section 269Q contains a power for HM Treasury to make consequential amendments to the Part in light of any changes to the Financial Services and Markets Act

2000 (Regulated Activities) Order 2001, the PRA Handbook, European Union Regulations, or appropriate accounting standards; where the Part relies on definitions or meanings from these sources it may be necessary to adapt to changes in them.

***Part 2: Consequential amendments***

38. Paragraph 2 gives effect to the carry forward of expenses of management where they are not useable because of the restriction under Part 7A. The carry-forward of trading losses and non-trading deficits denied by the restriction will happen without the need for any amendments.

39. Paragraphs 3 and 4 integrate Part 7A with the rest of CTA 2010

40. Paragraph 5 amends Part 9A of TIOPA 201 to deny relief to banking companies for pre-2015 carried-forward non-trading deficits and management expenses as part of a claim to relevant allowances under section 371UD of that Act (carried forward trading losses are already unavailable). This gives the same treatment to CFC charges of a banking company and profits arising from arrangements under the new section 269M.

***Part 3: Commencement and anti-forestalling***

41. Sub-paragraphs 6(1) and (2) provide for the commencement for Part 7A: the restriction applies to calculation of profits of accounting periods after 1 April 2015, and the anti-avoidance rule in new section 269M applies to arrangements entered into from announcement on 3 December 2014. This interacts with sub-paragraphs (3) and (4) so that any accounting period straddling 1 April 2015 is split into two periods for the purposes of the new Part, and:

- Where there is a profit for the accounting period, the Part will apply to calculation of profits of the part-period commencing 1 April 2015; whilst
- Where there is a loss for the straddling accounting period, the relevant reliefs arising in the part-period ending 31 March 2015 will be within the restriction.

42. Sub-paragraphs 6(3) and (4), as noted above, ensures that where a period straddles that date it is split into two periods: one ending 31 March 2015 and one beginning 1 April 2015. If the result of the straddling accounting period is a profit it is apportioned between the two periods; if the result is a loss it is apportioned between the two periods. The default apportionment method is time, unless that would give an unjust or unreasonable result. The apportionment by any method cannot create a profit in one part-period and a loss in the other; it can only split the overall result for the accounting period between the two part-periods.

43. Paragraph 7 contains the commencement and transitional rules for the changes to Part 9A, and provides that the denial of pre-2015 restricted relief against the CFC charge is against such a charge as arises from accounting periods of a CFC commencing after 1 April 2015. Where a charge arises from a CFC's accounting period straddling that date it will be

apportioned on a time basis (or another if that is unjust or unreasonable) and the apportioned charge from the split period commencing 1 April 2015 is denied relief.

44. Paragraph 8 comes into force at announcement on 3 December 2014 and is an anti-forestalling rule targeting arrangements to accelerate the use of reliefs that will be restricted from 1 April 2015. The paragraph applies to arrangements entered on or after 3 December 2014 and to calculation of profits of any accounting periods, or parts thereof, falling between that date and 1 April 2015. Where arrangements meet the conditions, the reliefs that will become restricted under Part 7A are not available against profits of the arrangements.

## **BACKGROUND NOTE**

45. This new Part was announced for the first time at Autumn Statement 2014.

46. The anti-forestalling rule applies from 3 December 2014 and to arrangements entered from that date. The Part itself and the consequential amendments apply from 1 April 2015, including an anti-avoidance rule applying to arrangements entered into from 3 December 2014.

47. Banks have built up exceptionally large losses, a consequence of financial crisis write-downs and the costs associated with subsequent mis-selling. The Government considers it unfair that banks can now use these losses to eliminate tax on recovering profits.

48. This Part will restrict the rate at which these losses can be off-set against taxable profit, increasing corporation tax payments from the sector during this period of fiscal consolidation.

49. If you have any questions about this change, or comments on the legislation, please contact James Konya on 03000 544525 (email: [james.konya@hmrc.gsi.gov.uk](mailto:james.konya@hmrc.gsi.gov.uk)).