Clause X: Reduction of relief in cases where losses relieved sideways etc

Summary

1. The clause limits the amount of double taxation relief (DTR) available to a company for foreign tax paid on income of a foreign permanent establishment (PE) of the company where losses of the PE have been relieved against income other than those of the PE in the foreign territory. The change applies from 22 November 2017.

Details of the clause

2. Subsections 1 and 2 insert new sections 71A and 71B into the double taxation relief (DTR) rules in Part 2 of TIOPA 2010.

3. New sections 71A(1)-(4) set out the circumstances in which the new section 71B applies to limit DTR. It applies for an accounting period where a company has a PE situated in a foreign territory and condition A or B is met in that period, or any earlier accounting period (which includes periods before the start date of the clause, subject to the limitation contained in subsection (7)).

4. Both conditions A and B are concerned with the treatment under the tax rules of the foreign territory of a loss or other amount attributable to the PE. They ask whether such an amount has been relieved against amounts other than of the PE or of the company, such as profits or other income arising in other entities. If losses or other amounts have been so relieved, resulting in a decrease in foreign tax chargeable for a foreign taxable period ending in the (UK) accounting period in question, then Condition A or B will be met for that accounting period.

   This might occur, for instance, where the results of the PE are consolidated for the purposes of the foreign tax rules with the results of other entities through a fiscal consolidation or similar arrangement, or if the foreign territory allows losses of the PE to be relieved against income of another group company.

5. New section 71B(1) modifies the calculation of credit relief for an accounting period in respect of foreign tax on a PE's qualifying income. In calculating the amount of relief allowable, the amount of foreign tax must instead be treated as reduced by the "relevant amount" (as defined in new s71A(3)) for that accounting period, but not so as to reduce the amount below nil.

6. New section 71B(2) provides for a similar modification of the calculation of any deduction for foreign tax from the company's income.

7. New sections 71B(3) and (4) describe how to arrive at the "relevant amount" for an accounting

period. It comprises two elements:

- The first element is the amount of the decrease in foreign tax as a result of the loss or other amount attributable to the PE being relieved against other income in the foreign territory where condition A or B is met for the accounting period in question.
- The second element is the amount of any "excess" carried forward from the previous accounting period. It is arrived at through an iterative process whereby the "relevant amount" for each previous accounting period is reduced by the amount of foreign tax on the PE's qualifying income for that period and any excess is carried forward to the next accounting period. It reflects the extent to which losses (or other amounts) of the PE have been relieved against other income in the foreign territory where condition A or B is met in earlier accounting periods.

8. Illustrating this through a simple example, assuming a foreign tax rate of 35% and that the foreign taxable periods are the same as the accounting periods (APs):

   - In AP1, the PE makes a loss of 1000 of which 800 is relieved against other income in the foreign territory and 200 is carried forward. The relevant amount is 280 (35% of 800) and an excess of 280 is carried forward to AP2.
   - In AP2, the PE makes a further loss of 200. This loss, together with the loss carried forward of 200, (totalling 400) are relieved against other income in the foreign territory. The relevant amount is then 420 (280 +140) and an excess of 420 is carried forward to AP3.
   - In AP3 the PE makes profit of 700 on which foreign tax of 245 is paid. The relevant amount is 420, so an excess of 175 is carried forward to AP4 and there is no credit relief allowable.
   - In AP4, there is a PE profit of 600 on which foreign tax of 210 is paid. The relevant amount is 175 so for the purposes of allowing credit relief, foreign tax of 35 is treated as paid.

9. New section 71B(5) ensures that the new provisions do not apply where Part 6A TIOPA 2010 (Hybrid and other mismatches rules) applies a counteraction to a deduction or allowance which would otherwise be within the new DTR rules.

10. New section 71B(6) allows for appropriate adjustments to be made to the relevant amount if necessary, notwithstanding the normal time limits. This might be necessary, for instance, if the amount of loss of a PE that is allowed against other income subsequently changes.

11. Subsection (3) provides that the existing definition of "overseas permanent establishment" in section 78 TIOPA applies for new sections 71A and 71B.

12. Subsection (4) ensures that where a deduction for an amount of foreign tax is treated as reduced by the relevant amount under new section 71B(2), this applies for the purpose of deductions for foreign tax from income under section 112 TIOPA.
13. Subsections (5) and (6) are the commencement provisions. The new rules apply from 22 November 2017 and subsection (6) sets out how they apply where the company's accounting period falls across that date.
14. Subsection (7) is a transitional provision that ensures that in applying the computational rules in new section 71B, earlier accounting periods beginning on or after 22 November 2011 must be considered as if section 71B applied for those periods.

Background note

15. The double taxation relief (DTR) rules in Part 2 TIOPA 2010 provide for credit relief for foreign tax paid on a company's qualifying income from a foreign permanent establishment (PE) against corporation tax on the income.
16. The changes made by this clause will amend the DTR rules where a foreign PE has made a loss that has been relieved for the purposes of the foreign tax rules against income other than of the PE in the foreign territory. It will restrict the amount of foreign tax that is treated as available for DTR for an accounting period to reflect the extent to which a loss of the PE has been relieved in this way in the period and earlier periods. This will ensure that DTR is confined to circumstances where income of a PE has effectively suffered double taxation.