These notes refer to the Corporation Tax Act 2009 (c.4) which received Royal Assent on 26 March 2009

CORPORATION TAX ACT 2009

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 2: Charge to corporation tax: basic provisions

Chapter 4: Non-UK resident companies: chargeable profits

Overview

104. This Chapter sets out which profits of a non-UK resident company are liable to corporation tax. It is based on sections 11 and 11AA of, and Schedule A1 to, ICTA.

105. The Schedules themselves contain rules on territorial scope. Section 18(1)(a)(i) and (ii) of ICTA brings within the charge to tax under Schedule D annual profits or gains accruing to a *UK resident* from (a) any kind of property whatever wherever situated and (b) from any trade wherever carried on. Section 18(1)(a)(iii) brings within the same charge to tax annual profits or gains accruing to a *non-UK resident* from any property in the United Kingdom or from any trade or profession exercised there. Section 18 of ICTA is not itself a charge but a method of computing and marshalling under a Schedule income that is charged to tax under section 6 of ICTA.

106. Section 9 and section 18(4A) of ICTA apply section 18(1) (Schedule D) of ICTA for corporation tax purposes. But section 11 of ICTA sets out another rule on the scope of the corporation tax charge on a non-UK resident company.

107. The scope of Schedule D in section 18 of ICTA is narrower than the charge in section 11 of ICTA. Under section 18 non-UK residents are only liable to tax in respect of annual profits or gains from property in the United Kingdom or from trades exercised there. Under section 11 a non-UK resident company is chargeable to corporation tax on all profits wherever arising that are attributable to its permanent establishment in the United Kingdom and on income from property or rights held by or for the permanent establishment through which it trades. There is no requirement that that property should be in the United Kingdom.

108. The seventh edition (1999) of *Taxation of Companies and Company Reconstructions* by Bramwell *et al* (footnote to page 421) says of section 11(2):

> These words appear to be rather wider than the income tax "profits or gains arising from any trade exercised within the United Kingdom". It is possible that the corporation tax charge on trading profits extends beyond the income tax charge, perhaps, for example, in the area of overseas activities connected with a United Kingdom branch.

109. Section 70(3) of ICTA enables a non-UK resident company to be charged to corporation tax under Schedule D Case V.

110. Prior to the removal of Case IV for corporation tax purposes in FA 1996, section 70(3) of ICTA extended Schedule D Cases IV and V to non-UK residents. (The replacement of "Case IV" by "Case III" as a consequential amendment in FA 1996 made little

sense since section 18(3A) of ICTA already brought income arising outside the United Kingdom into Schedule D Case III for corporation tax purposes.)

111. The FA 1965 Notes on Clauses for the section on which section 70(3) of ICTA is based read:

(This clause) provides machinery for charging any overseas income attributable to the branch in the United Kingdom of a non-resident company trading here through the branch. Such a branch may have funds which are recognisably attributable to branch operations but deposited abroad and earning interest whilst still held to the branch's account. The machinery selected is that of Cases IV and V (which applies to overseas income of residents of the United Kingdom).

112. Section 70(3) of ICTA would seem to confirm that non-UK resident companies can be charged on income arising outside the United Kingdom and thus confirm the wider scope and precedence of section 11 of ICTA over section 18(1)(a)(iii) of ICTA (see above).

113. Section 18(1)(a)(iii) of ICTA is therefore redundant for corporation tax purposes because it adds nothing to section 8 of ICTA, which deals with the scope of corporation tax generally, and section 11 of ICTA.

114. Section 70(3) is not rewritten. The section adds nothing to the basic position of a non-UK resident company under sections 5(3) and (4) and 19. Moreover the parenthetical words in section 70(3) ("but without prejudice to any provision of the Tax Acts especially exempting non-residents from tax on any particular description of income") apply on first principles to income falling within the definition of "chargeable profits".

115. A reordering of the sections on permanent establishments in this Chapter is intended to clarify the relationship between the various provisions. First comes the charge on the profits attributable to the permanent establishment followed by an introductory section explaining how the sections are set out and how they apply.

116. This is followed by the sections on the separate enterprise principle. Those that apply this principle specifically to banks are at the end of this group of sections. The special rules on deductions then appear at the end of the Chapter.

117. Much of the terminology employed in sections 11 and 11AA of, and Schedule A1 to, ICTA is shared in common with the Model Tax Treaty and Commentary of the Organisation for Economic Cooperation and Development (OECD). Indeed the legislation is intended to reflect to a considerable degree the Model Treaty and Commentary. This terminology is retained so that the relationship between the two is not lost.

Section 19: Chargeable profits

118. This section sets out what profits of the non-UK resident company are charged to tax. It is based on sections 11(1) to (2A) and 11AA(1) of ICTA.

119. *Subsection (2)* provides that income and chargeable gains form part of the non-UK resident company's chargeable profits only if they are of a type specified in *subsection (3)* and are attributable to the company's permanent establishment. This is a rather different approach to that in section 11(2A) of ICTA but, read with section 11AA(1) of ICTA, it seems that section 11(2A) of ICTA is merely identifying the types of income and gains that are capable of being attributed to the permanent establishment and not giving the amount of those income and gains.

120. Subsection (3)(c) brings into the chargeable profits of a company chargeable gains falling within section 10B of TCGA. The chargeable gains falling within that section are those accruing to a company on the disposal of assets situated in the United Kingdom. Such gains are relevant in this context if the assets in question are connected with the

trade carried on by the company through the permanent establishment or are for use by or for the purposes of the establishment.

121. "Permanent establishment" is defined in section 148 of FA 2003 and appears in Schedule 4 (index of defined expressions).

122. Neither the words "subject to any exceptions provided for by the Corporation Tax Acts" nor the second sentence of section 11(2) of ICTA are rewritten as they are considered unnecessary.

Section 20: Profits attributable to permanent establishment: introduction

123. This section describes how the sections that follow are set out and how they apply. It is based on section 11AA(1) of ICTA.

Section 21: The separate enterprise principle

124. This section sets out the basic rule of the separate enterprise principle. It is based on section 11AA(2) and (3) of, and paragraph 1(2) of Schedule A1 to, ICTA.

125. The terms "distinct and separate enterprise" and "credit rating" in this section are unique to section 11AA of ICTA. The former term is taken from Article 7 of the Model Treaty and the latter from the commentary on that article. The meaning of the former is well understood from its use in double taxation conventions while the latter takes its normal commercial meaning, a meaning that is well established through credit ratings given by agencies such as Moody's or Standard and Poor.

Section 22: Transactions treated as being on arm's length terms

126. This section provides the rule for dealing with transactions between the permanent establishment and the rest of the non-UK resident company. It is based on paragraph 2 of Schedule A1 to ICTA.

Section 23: Provision of goods or services for permanent establishment

127. This section sets out the rule for goods and services provided by the non-UK resident company to the permanent establishment. It is based on paragraph 6(1) to (3) of Schedule A1 to ICTA.

128. Although this section deals with both a deduction (expense) – see *subsection (3)* – and the separate enterprise principle, it is grouped with other sections dealing with the separate enterprise principle as that is the main rule here and to separate these elements would be unhelpful.

Section 24: Application to insurance companies

129. This section provides the power for the making of regulations in respect of the application of section 21 to insurance companies. It is based on section 11AA(5) of ICTA.

Section 25: Non-UK resident banks: introduction

130. This section introduces sections 26 to 28 which contain particular provisions applying the separate enterprise principle to banks. It is based on paragraph 7(1) and (2) of Schedule A1 to ICTA.

131. While these provisions are an application of the separate enterprise principle with particular relevance to banks, the principles behind them are applicable to companies other than banks and *subsection (2)* clarifies this point.

Section 26: Transfer of financial assets

132. This section applies the separate enterprise principle to loans or financial assets transferred between the permanent establishment and any other part of the company. It is based on paragraphs 7(1) and 8(1) and (2) of Schedule A1 to ICTA.

133. Each of the sections applying the separate enterprise principle to banks contains the phrase "in accordance with the separate enterprise principle" to clarify that the provisions given are all within the general principle in section 21 and not expressing new principles.

134. *Subsections (3)* and *(4)* retain the term "valid commercial reasons" in paragraph 8(2) of Schedule A1 to ICTA notwithstanding that the usual phrase adopted in rewrite Bills is either "commercial reason" or "genuine commercial reason". This is because "valid commercial reason" is the term used in the Commentary (paragraph 15.2) to Article 7(2) of the treaty.

135. Subsection (4) also contains the term "tax advantage". The term is undefined (as in the source legislation) although its use elsewhere in the Taxes Acts refers to the definition in section 709 of ICTA. The absence of a definition in paragraph 8(2) of Schedule A1 is intentional. It was considered that any attempt to define all possible and future forms of tax advantage in this context would have added complexity for no good purpose.

Section 27: Loans: attribution of financial assets and profits arising

136. This section explains how a financial asset (eg a loan) made by the non-UK resident company and the profits arising from it should be attributed (whether to the permanent establishment or another part of the company). It is based on paragraphs 7(1) and 9(1) and (3) to (5) of Schedule A1 to ICTA. An example would be where a permanent establishment in the United Kingdom obtains new business and passes that business back to the overseas part of the company. Resulting loans, derivatives etc can be attributed to the permanent establishment under this section notwithstanding that they have been issued by an overseas office.

Section 28: Borrowing: permanent establishment acting as agent or intermediary

137. This section applies the separate enterprise principle where a permanent establishment of a non-UK resident bank acts as an agent or intermediary in borrowing funds for another part of the company. It is based on paragraphs 7(1) and 10(1) and (2) of Schedule A1 to ICTA.

Section 29: Allowable deductions

138. This section brings together some general rules on deductions allowable in arriving at the profits of a permanent establishment. It is based on section 11AA(4) of, and paragraph 3(1) and (2) of Schedule A1 to, ICTA.

139. "Executive and general administrative expenses" in *subsection (2)* are not defined. The term is borrowed from Article 7(3) of the OECD Model Treaty. The Commentary on the Model Treaty does not define the term further but "executive expenses" would seem to cover the expenses of higher management of the permanent establishment.

Section 30: Restriction on deductions: costs

140. This section is the first of three sections which restrict deductions in arriving at the attributable profits of a permanent establishment. It provides that no deduction for costs should exceed what would be payable under the separate enterprise principle. It is based on section 11AA(3) of ICTA.

Section 31: Restriction on deductions: payments in respect of intangible assets

141. This section disallows a deduction for inter-company payments for the use of intangibles where the intangible assets are held by the company. The reasoning here is that it is difficult to allocate ownership of intangibles to any one part of a company as if it were an independent enterprise. The section is based on paragraph 4(1) to (3) of Schedule A1 to ICTA.

Section 32: Restriction on deductions: interest or other financing costs

142. This section applies the same principle as the previous section but to interest payments. An exception is, however, made for companies dealing in loans, debts commodities and futures. It is based on paragraph 5(1) to (3) of Schedule A1 to ICTA.