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 1: The charge to corporation tax

Overview

29. The process of separating income tax and corporation tax began with ITTOIA and continued with ITA, which substantially completed the rewrite of income tax legislation for income tax purposes. Following that there were two parallel sets of income tax principles. Those in rewrite style apply only for income tax purposes and, for example, no longer include Schedules such as Schedule D and its Cases.

30. Prior to this Act corporation tax has been dependent on the continuing existence of the income tax rules in unrewritten style so that, for example, those Schedules and Cases continue to be applied for the purposes of corporation tax.

31. This Act continues and finalises the separation process so that the relevant principles apply separately for corporation tax. The adoption of this approach means that section 9 of ICTA (computation of income: application of income tax principles) is repealed by this Act (apart from section 9(5) which theoretically could have a continuing effect). Some of the provisions of section 9 of ICTA are rewritten in section 969 and there is a transitional provision in Schedule 2.

32. This Chapter deals with the charge to corporation tax on profits. The approach retains the principle of a single charge, currently under section 6 of ICTA. The charge under section 2 is on amounts of income and on chargeable gains that together form the "profits pot".

33. This contrasts with the multiple charges to income tax in the Income Tax Acts, primarily ITTOIA, and reflects the different history of the two taxes.

34. The way the charge on profits operates is explained in the commentary on section 2. This section rewrites both section 6(1) and (4) of ICTA and section 9(1) and (4) of that Act. In the light of the separation of corporation tax from income tax it is necessary to find a different way of expressing the relationship between the general charge to corporation tax on income and the provisions that deal with its application.

35. There are also other charges to corporation tax. These are charges to an amount of corporation tax and they do not feature in the "profits pot". There is an example of this kind of charge in this Act – in section 75{j032704}(2) (retraining courses: recovery of tax).

36. These are provisions of an administrative nature mainly recovering excessive relief. In some of the charges of this kind there are references to the assessment being made under Schedule D Case VI. The Case VI label will disappear along with Schedule D and the other Cases with the repeal of section 18 of ICTA. The references are removed by

consequential amendments in Schedule 1. An example is the amendment to paragraph 27(4) of Schedule 16 to FA 2002.

Section 2: Charge to corporation tax

37. This section provides the charge to corporation tax on profits. It is based on section 6(1) and (4) and section 9(1) and (4) of ICTA.

38. *Subsection (1)* states that corporation tax on profits is charged for a financial year for which an Act provides. It is based on the two overlapping propositions in section 6(1) of ICTA.

39. Under *subsection (2)* "profits" in Part 2 means "income and chargeable gains, except in so far as the context otherwise requires". This interpretation derives from section 6(4) of ICTA. This Act amends section 6(4) of ICTA in Schedule 1.

40. Chargeable gains are defined in section 1(1) of TCGA. In *subsection (3)* " the charge to corporation tax on income" is introduced as a label. The expression is defined for corporation tax purposes as a result of an amendment to section 834(1) of ICTA made by Schedule 1 to this Act.

41. *Subsection (4)* provides that the charge to corporation tax on income in effect depends on there being another provision of the Corporation Tax Acts that applies it.

42. This subsection is based on section 9(1) and (4) of ICTA. Section 9(1) in effect controls the meaning of "income" in section 6 of ICTA. As noted in the overview, this Act will complete the split between income tax and corporation tax and the formulation in section 9(1) of ICTA is no longer apposite since its wording is adapted to the circumstances of applying one body of tax law (income tax principles) for the purposes of another tax (corporation tax).

43. The effect of section 9 of ICTA is that the scope of the charge to income tax determines what is income for corporation tax purposes (except as otherwise provided by the Tax Acts). Income tax, although primarily a charge to tax on things which would be regarded as income in its ordinary sense, is not exclusively a charge on such things. Section 9(4) provides that anything that is within the charge to income tax is within the charge to corporation tax on income "whether expressed to be income or not and whether an actual amount or not".

44. So the effect of section 9 of ICTA is that (subject to the provisions of the Corporation Tax Acts) the charge to corporation tax on income is driven by the particular heads of the charge to income tax.

45. The purpose of this section is to achieve an equivalent effect, so that the charge to corporation tax on income is driven by the particular heads of the charge to corporation tax on income. In this way the section substitutes the provisions of the Corporation Tax Acts for the income tax provisions. For example section 35 applies the charge to corporation tax on income to the profits of a trade.

Section 3: Exclusion of charge to income tax

46. This section ensures that income of a company within the charge to corporation tax is not chargeable to income tax as well as corporation tax. It is based on section 6(2) of ICTA.

Section 4: Exclusion of charge to capital gains tax

47. This section ensures that chargeable gains of a company within the charge to corporation tax are not chargeable to capital gains tax as well as corporation tax. It is based on section 6(3) of ICTA.

Section 5: Territorial scope of charge

48. This section sets out the territorial scope for the charge to corporation tax. It is based on section 8(1) and section 11(1) and (2) of ICTA.

49. *Subsection (1)* deals with the position of companies resident in the United Kingdom. It restates section 8(1) of ICTA which, although expressed in general terms, only has effect in relation to UK resident companies (because of the exception under section 11 for non-UK resident companies).

50. Chapter 3 of this Part sets out the statutory rules for company residence. Chapter 4 explains what are chargeable profits in the case of non-UK resident companies.

Section 6: Profits accruing in fiduciary or representative capacity

51. This section deals with profits accruing directly to the company where it is acting in a fiduciary or representative capacity, for example as a nominee. It is based on section 8(2) of ICTA.

52. In this case the charge under section 2 only applies where the company has a beneficial interest in the profits.

53. When a company goes into liquidation it ceases to be the beneficial owner of its assets. The exception in *subsection (2)* means that in this case the company's profits remain within the charge to corporation tax.

Section 7: Profits accruing under trusts

54. This section sets out the treatment of profits that do not accrue to the company directly but in which the company has a beneficial interest under a trust. It is based on section 8(2) of ICTA.

55. The words "in any case in which it would be so chargeable if the profits accrued to it directly" are not reproduced because the treatment for which the section provides makes them unnecessary. Profits which are treated as accruing to a company directly are chargeable to corporation tax in the same circumstances that they would have been had they in fact accrued directly to the company.

56. There is no reference to profits arising under a partnership in contrast to section 8(2) of ICTA. Provisions for the charge to corporation tax on the profits of corporate partners are set out elsewhere in this Act and in particular in Part 17.

Section 8: How tax is charged and assessed

57. This section sets out how corporation tax is charged and assessed. It is based on section 8(3) and section 12(1) of ICTA.

58. The reference to deductions in section 8(3) and section 12(1) of ICTA and the words in brackets in section 12(1) "(whether or not received in or transmitted to the United Kingdom)" have not been rewritten since they do not add anything substantive to these provisions. There are rules elsewhere about what deductions can be made and this section together with section 5 make it clear that the charge is on profits wherever arising.

59. Section 70(1) is not rewritten in this Act but is reflected in *subsection (3)* of this section which contains the general rule about the basis of assessment.

Chapter 2: Accounting periods

Overview

60. This Chapter gives the definition of accounting period. It is based on section 12 of ICTA.

61. The accounting period is a basic building block of corporation tax because corporation tax is charged by reference to accounting periods. For nearly all established UK resident companies the accounting period coincides with the 12 month period for which it makes up its accounts. Most of the Chapter is taken up with rules explaining what happens outside the usual case.

62. The Chapter does not rewrite section 12(8) of ICTA. Section 12(8) is an administrative provision that deals with the validity of assessments. The Chapter is concerned with when accounting periods begin and end, and not with the circumstances in which an officer of Revenue and Customs may make an assessment or determination.

Section 9: Beginning of accounting period

63. This section identifies when an accounting period begins. It is based on section 12 and section 342A of ICTA.

64. *Subsection (1)(a)* deals with the case in which a company comes within the charge to corporation tax. Subsection (1)(a) states an important general rule. This Act does not reproduce the two examples given in section 12(2)(a) of ICTA of circumstances in which this general rule would apply (becoming UK resident, acquiring a source of income). The examples add nothing useful and might obscure the general rule.

65. *Subsection (1)(b)* deals with the usual case of a company that is already within the charge to corporation tax so that a new accounting period begins when the previous accounting period ends.

66. *Subsection (4)* disapplies this section in the case of a company being wound up. Section 12, which makes special provision about companies being wound up, applies instead.

67. *Subsection (6)* is a general signpost that, in certain circumstances, the rules in this section are modified by rules in other provisions of the Corporation Tax Acts that deal with particular cases. The implications for accounting periods will be clear when considering the cases in question (for example, paragraph 3 of Schedule 10 to FA 2006 (sale of lessor companies) and paragraph 52 of Schedule 22 to FA 2000 (tonnage tax)).

Section 10: End of accounting period

68. This section identifies the end of an accounting period. It is based on section 12 of ICTA.

69. The starting point for the section to apply is that the company has an existing accounting period. The occurrence of any one of the listed events brings that accounting period to an end. In many cases section 9(1)(b) then applies to start a new accounting period.

70. The opening words of *subsection (1)* provide that an accounting period ends "on the first occurrence of any of" the events listed in paragraphs (a) to (j). These words fall to be read in relation to each accounting period which is commenced. The effect of these words is not that the first event on that list to occur settles how all subsequent accounting periods of that company are to end. Rather, the effect is that each accounting period may be ended by the occurrence of a different event, depending on what happens in that particular accounting period.

71. The rules applying to companies in administration have been integrated into the general rules. The case is different from where a company is being wound up. In that case (see section 12) there is a self-contained set of rules about when a company's accounting periods end. In the case of a company in administration, the general rules

about when an accounting period of a company end continue to apply, but there are two additional circumstances in which an accounting period ends. These are the circumstances mentioned in subsection (1)(i) and (j).

72. The legislation rewritten by subsections (1)(i) and (j), (2), (3) and (4) only applies to companies that enter administration on or after 15 September 2003. This limitation is preserved in Schedule 2 (transitionals and savings).

Section 11: Companies with more than one accounting date

73. This section allows a company carrying on more than one trade to nominate the accounting date which marks the end of the accounting period. It is based on section 12 of ICTA.

74. The section is most likely to apply to a non-UK resident company carrying on more than one trade in the United Kingdom through a permanent establishment. If a UK resident company carries on more than one trade it prepares a single set of accounts to cover all the company's activities. A non-UK resident company may not be subject to these regulatory requirements. Without this section an accounting period would end at each separate accounting date.

75. The company is allowed to choose which accounting date is used for the purposes of the test in section 10(1)(b). The company's choice is subject to review by HMRC. In the source legislation this power is exercised by the Commissioners for HMRC. In practice it is exercised by an officer. *Subsection (3)* reflects that. See *Change 1* in Annex 1.

76. The source legislation does not provide for the situation where a company has one or more businesses in addition to its trades, or several businesses but no trade. The effect is that the company's choice and the officer of Revenue and Customs' discretion is limited to selection of an accounting date relating to one of the company's trades. In other words, neither the company nor the officer can choose as the accounting period end date an accounting date of one of the company's businesses which is not a trade.

Section 12: Companies being wound up

77. This section identifies the beginning and end of an accounting period if a company is being wound up. It is based on section 12 of ICTA.

78. Although the rules applying to companies in administration have been integrated into the general rules (see section 10(1)(i) and (j)), the separate exposition of the rules applying to companies being wound up have been preserved. This is because the scheme of section 12(7) of ICTA is to provide for a self-contained set of rules about when an accounting period ends. It follows that the accounting period of a company being wound up does not end on the occurrence of any of the events listed in section 10(1)(b) to (j). Accordingly, it is not appropriate to add the termination events listed in section 12 to the list of termination events in section 10(1).

79. *Subsection (5)* is new. It makes provision for when a new accounting period of a company being wound up begins. Section 12(7) of ICTA provides for an accounting period to begin on the commencement of winding up, but does not provide for the commencement of any subsequent accounting period. The rule in section 12(2)(b) of ICTA, now section 9(1)(b) of this Act, continues to apply for that purpose. It is preferable to make separate provision for the commencement of a new accounting period after the end of 12 months, rather than rely on section 9(1)(b) for this purpose.

80. The reason for this is that the rule in clause 9(1)(b) of this Act is that a new accounting period only begins at the end of 12 months if the company is still within the charge to corporation tax. However, section 12(7) of ICTA does not make the company's remaining within the charge to corporation tax a condition of a new accounting period starting on the company beginning to be wound up. Also, that provision states that "an accounting period shall not end otherwise than by the expiration of 12 months from its

beginning". Given that, section 12(2)(b) of ICTA must necessarily be modified in its application to companies being wound up.

Chapter 3: Company residence

Overview

81. This Chapter gives the statutory rules for company residence outside double taxation conventions.

82. The rules on company residence are both statutory and non-statutory. The oldest of the company residence rules ("central management and control") is based on common law.

83. The central management and control test is generally considered to be best expressed in De Beers Consolidated Mines v Howe (1905), 5 TC 198 HC. "A company resides, for the purposes of Income Tax, where its real business is carried on … I regard that as the true rule; and the real business is carried on where the central management and control actually abides". This has been endorsed by subsequent decisions and was described by Lord Radcliffe in Bullock v Unit Construction Company (1959), 38 TC 712 HL as being "as precise and unequivocal as a positive statutory injunction".

84. Residence may also be determined by the tie-breaker in a double taxation convention. When a company is resident in the territory of both parties a tie-breaker generally awards residence to the country where the effective management of the company is situated.

85. The two main statutory rules are found in section 66 of FA 1988 and section 249 of FA 1994. These two tests are rewritten in this Chapter.

86. Under section 66 of FA 1988 a company incorporated in the United Kingdom is, with some exceptions, regarded as resident here for all tax purposes. This overrides the rule in common law given above, although the common law test continues for companies outside section 66, that is to say companies which are not incorporated in the United Kingdom.

87. Section 249 of FA 1994 treats a company resident in the United Kingdom under the common law test or section 66 of FA 1998 as being non-UK resident if the tie-breaker in the double taxation treaty between the United Kingdom and that other territory would make the company resident outside the United Kingdom.

88. Both these statutory rules apply for the purposes of the Taxes Acts as defined in section 118 of TMA (see section 66(1) and 66A(2) of FA 1988 and section 249(1) of FA 1994). This Act rewrites the rules for the purposes of the Corporation Tax Acts only. Because the Corporation Tax Acts are defined more narrowly (Schedule 1 to the Interpretation Act 1978) than the Taxes Acts, Schedule 1 to this Act inserts new sections into TMA, TCGA and ITA to apply the rules given in this Chapter to those Acts.

Section 13: Overview of Chapter

89. This section sets out which residence rules are dealt with in this Chapter. It is new.

90. Although this Chapter does not legislate the common law test on residence (see above), *subsection (3)* makes clear that section 15 applies where a company has been resident in the United Kingdom under that test.

Section 14: Companies incorporated in the United Kingdom

91. This section provides that a company incorporated in the United Kingdom is resident here for corporation tax purposes and, under section 5, is within the charge to corporation tax on all its income and chargeable gains. It is based on section 66(1) of FA 1988.

92. *Subsection (2)* makes it clear that a company which is resident in the United Kingdom under *subsection (1)* is not resident in any other territory.

93. Although section 66 of FA 1988 and section 249 of FA 1994 refer to a company being "regarded as" resident it is not considered necessary to adopt that or similar wording. A company is simply resident somewhere.

Section 15: Continuation of residence established under common law

94. This section gives rules on residence for companies which are not incorporated in the United Kingdom. Companies which were UK resident immediately before they ceased business or came under the control of a foreign liquidator continue to be treated as UK resident. The section is based on section 66(2) of FA 1988.

95. This section clarifies that the provision applies only to companies which are not incorporated in the United Kingdom. That is less clear in the source legislation. Any United Kingdom incorporated company which ceases business or is being wound up outside the United Kingdom is already UK resident under the rule in the previous section.

96. The purpose of the rule in this section is to provide that a company which is resident in the United Kingdom through central management and control (see above) remains resident here. Such a company could otherwise become non-UK resident if central management and control left the United Kingdom.

97. Section 66(4) of FA 1998 gives effect to Schedule 7 to that Act, the commencement and transitional provisions. Paragraphs of that Schedule which are not spent are rewritten in Schedule 2 (transitionals and savings) to this Act.

Section 16: SEs which transfer registered office to the United Kingdom

98. This section provides that once an SE ("Societas Europapaea" – see section 1319) has transferred its registered office to the United Kingdom it becomes and remains resident there, notwithstanding its residence elsewhere under overseas law or the subsequent transfer of its office abroad. The section is based on section 66A of FA 1988.

99. This section applies only to SEs which transfer their registered office to the United Kingdom since SEs that are formed here are resident in the United Kingdom in any event under section 14.

100. Once the registered office is moved to the United Kingdom the SE is effectively treated as if it were incorporated there. It cannot cease to be resident at any time simply by transferring its registered office.

Section 17: SCEs which transfer registered office to the United Kingdom

101. This section provides the same rule for SCEs (European Cooperative Societies – see section 1319) that section 16 provides for SEs. It is based on section 66A of FA 1988.

Section 18: Companies treated as non-UK resident under double taxation arrangements

102. Under this section a company which is resident in the United Kingdom, but treated under a double taxation convention as resident in a territory outside the United Kingdom, is resident outside the United Kingdom for corporation tax purposes. The section is based on section 249 of FA 1994.

103. Section 250 of FA 1994 is spent. It is repealed by this Act.

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.

Chapter 5: Supplementary

Section 33: Trade includes office

143. This section provides that trade includes an office in Part 2 of this Act, subject to context. It is based on section 6(4) of ICTA which applies the definition of "trade" in paragraph (b) of that subsection to various provisions of ICTA, except in so far as the context otherwise requires.

144. The reference to "carrying on a trade" in *paragraph (b)* is new. It reflects one of the usages of "trade" in Part 2.

145. The interpretation does not refer to employment or vocation. The treatment of vocations is discussed in *Change 2* in Annex 1. A company does not hold an employment but it is not uncommon for a company to hold an office such as that of company secretary and the charge to corporation tax on income from an office is set out in section 969.

146. Section 969 applies the charge to corporation tax on income under section 2 to income from the holding of an office.