

# FINANCE ACT 2015

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## EXPLANATORY NOTES

### INTRODUCTION

#### ***Section 32 and Schedule 2: Restrictions Applying to Certain Deductions Made by Banking Companies***

##### **Summary**

1. This section and Schedule 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 Section**

3. **Section 32** introduces Schedule 2, which is made up of three Parts:
  - Part 1 inserts a new Part 7A into Corporation Tax Act 2010 (CTA 2010);
  - Part 2 makes consequential amendments to other parts of the Taxes Acts; and
  - Part 3 introduces anti-forestalling provisions and deals with commencement.

##### **Details of the Schedule**

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

##### ***Chapter 1 – Introduction***

4. New section 269A gives an overview of the part.

##### ***Chapter 2 – Key definitions***

5. New sections 269B to 269BC 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 section 269BD 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 269CK, which relies on a test of connection (the term connected read in accordance with section 1122 of CTA 2010).

7. New section 269BE 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 or FCA 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.

### ***Chapter 3 – Restriction on obtaining certain deductions***

8. New section 269C gives an overview of the Chapter.
9. New subsections 269CA(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.
10. New subsection 269CA(3) dis-applies the restriction where the company has no profits against which pre-2015 carried forward trading losses could be set.
11. New subsection 269CA(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.
12. New subsection 269CA(5) indicates sections regarding situations where the restriction on deduction does not apply.
13. New subsections 269CB(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.
14. New subsection 269CB(3) dis-applies the restriction where the company has no profits against which pre-2015 carried forward non-trading deficit could be set.
15. New subsection 269CB(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.
16. New subsection 269CB(5) clarifies that references to non-trading profits in new subsection 269CB(4) take the same meaning as section 457 of the Corporation Tax Act 2009.
17. New subsection 269CB(6) indicates sections regarding situations where the restriction on deduction does not apply.
18. New subsections 269CC(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.
19. New subsection 269CC(3) dis-applies the restriction where the company has no profits against which pre-2015 carried forward management expenses could be set.
20. New subsections 269CC(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. New subsection 269CC(4) also indicates sections regarding situations where the restriction on deduction does not apply.

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21. New subsection 269CC(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.
22. New subsection 269CD(1) establishes how relevant trading profits, relevant non-trading profits, and relevant profits are calculated. The calculation in this subsection should be performed before a calculation of the banking company's 'total profits' or 'taxable total profits' for the purposes of section 4 of CTA 2010, and any amounts of relief the company uses in this calculation will be the same in the calculations for the purposes of section 4.
23. In order to calculate a banking company's 'total profits' it will be necessary to first establish the amount of pre-2015 carried forward trading losses and non-trading loan relationship deficits that will be available following the restriction under this Part.
24. As management expenses are the first relief against total profits (section 1219(1A) of CTA 2009) it will also be necessary to establish the amount of pre-2015 management expenses available to the company for the purposes of calculating other reliefs against total profits in the calculation of the company's taxable total profits.
25. When relief claimed or otherwise allowed is factored into a calculation under this section, it is done on the basis that no pre-2015 carried forward trading losses, non-trading loan relationship deficits or management expenses are available; the amount of relief claimed or otherwise allowed as used in the calculation under this section is then the amount of relief that will be claimed or otherwise allowed in the banking company's calculations for the purposes of section 4 of CTA 2010. Hence, by first performing a calculation under this section in interaction with the rest of this Part, it is possible to establish the amounts of pre-2015 relief available to the company.
26. New subsection 269CD(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 be in effect be claimed against the 50 percent of profits remaining.
27. New section 269CE 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.
28. New subsections 269CF(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.
29. New subsection 269CF(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.
30. New subsection 269CF(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.
31. New subsection 269CF(7) brings the three reliefs affected by the Part into the definition of 'relevant carried forward loss' for this section.

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32. New subsection 269CF(8) directs to the following section for the definition of start-up period.
33. New subsection 269CG(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 269BB) instead of when it became a banking company for the purposes of this Part.
34. New subsections 269CG(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.
35. New subsection 269CG(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.
36. New subsections 269CG(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.
37. New subsections 269CG(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.
38. New subsection 269CG(9) includes joining a partnership in references to joining a group within the section.
39. New subsection 269CG(10) refers to new section 269CL for a definition of first beginning to carry on relevant regulated activity.
40. New section 269CH allows banking companies to use an amount of carried forward loss allowance to designate relevant carried-forward losses, within the meaning in new section 269N, as unrestricted so that the restriction within this Part does not apply.
41. The banking companies able to benefit from this section are building societies and companies which have been allocated an amount of carried-forward loss allowance under either of new sections 269CI or 269CJ. Building societies are those within the meaning of the Building Societies Act 1986.
42. The designation under this section is done in the banking company's tax return (see new Part 9E of Schedule 18 to Finance Act 1998 (FA 1998)).
43. A building society has an initial amount of £25,000,000 of carried-forward loss allowance which it can use to designate under this section. This amount is reduced where a building society designates an amount of carried-forward losses as unrestricted, or where a building society allocates an amount of the allowance to another company in its group under new sections 269CI or 269CJ. A building society may also re-allocate allowance back to itself under new section 269CJ.
44. For companies in the building society's group, the amount of allowance is the amount allocated under those sections, and is reduced when the company designates an amount of carried-forward losses as unrestricted.
45. To the extent a banking company's allowance is not used through designation in one accounting period it is available in any other accounting period.

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46. The allowance is not tied to an accounting period, so once a company has an amount of allowance allocated to it, it may designate losses as unrestricted in any original return or by amendment under the normal rules for amendment of a returns in Schedule 18 to FA 1998.
47. New section 269CI permits a building society to allocate carried-forward loss allowance amongst the banking companies in its group. Group takes its meaning from new section 269BD.
48. The section applies where:
  - a building society is in a group; and
  - the building society still has an amount of carried-forward loss allowance.
49. A building society is given an initial carried-forward loss allowance of £25,000,000. Only the amount of allowance that has not previously been designated by the building society or allocated to another company can be allocated under this section.
50. It is not necessary to allocate the full £25,000,000, and the building society may make multiple allocations under this section up to the limit of its remaining amount of carried-forward loss allowance in accordance with new subsection 269CH(5).
51. The building society can use the allowance without allocating it to itself, but a building society may not use any amount of allowance that has been allocated to another company.
52. A statement of allocation under this section must be submitted at or before the time when a company submits a tax return, or an amendment is made to a tax return, which makes a designation following the allocation made under this section. An officer of Revenue and Customs may accept a statement as valid after the return is submitted.
53. Any allocations made under this section are fixed unless a re-allocation is made under new section 269CJ.
54. New section 269CJ permits a building society to re-allocate the allowance amongst the banking companies in its group, or to re-allocate to itself an amount previously allocated to another company. Group takes its meaning from new section 269BD.
55. The section applies where:
  - a building society is in a group;
  - an allocation has previously been made under new section 269CI;
  - there is a company in the group, including the building society, with more relevant carried-forward losses than available carried-forward loss allowance; and
  - the additional carried-forward loss allowance which that company needs is greater than the amount the building society could allocate from its own carried-forward loss allowance under new section 269CI; but
  - there is unused carried-forward loss allowance in another company in the group.
56. Only the amount of allowance that has not been designated can be re-allocated, and any allowance previously allocated to a company that has since left the group will not be available for re-allocation.
57. Any banking company, including the building society, which has an amount of allowance re-allocated away from it no longer has that amount of allowance.
58. A statement of allocation under this section must be submitted at or before the time when a company submits a tax return, or an amendment is made to a tax return, which

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makes a designation following the re-allocation made under this section. An officer of Revenue and Customs may accept a statement as valid after the return is submitted.

59. Any re-allocation made under this section is fixed, subject to a further re-allocation made under this section.
60. New subsections 269CK(1) to (6) 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;
  - the main benefit, or one of the main benefits, of the arrangement is to secure a tax advantage for the company, or the company and connected companies; and
  - the value of the tax advantage is greater than value of any other economic benefit of the arrangements to the company, or the company taken with companies connected with it.
61. New subsection 269CK(7) 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.
62. New subsection 269CK(8) gives definitions for the section.
63. New section 269CL 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.
64. New section 269CM brings joint ventures into the same groups as the companies that jointly control it for the purposes of this part, relying on international accounting standards definitions.
65. New section 269CN defines various terms for the Part.

## **Part 2: Consequential amendments**

66. Paragraph 2 inserts a new Part 9E of Schedule 18 to FA 1998. This new Part contains rules for designation of relevant losses as unrestricted under new section 269CH.
67. Paragraph 3 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.
68. Paragraphs 4 and 5 integrate Part 7A with the rest of CTA 2010
69. Paragraph 6 amends the controlled foreign company (CFC) provisions in Part 9A of the Taxation (International and Other Provisions) Act 2010 (TIOPA 2010) 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 269CK.

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

70. Subparagraphs 7(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 269CK applies to arrangements entered into from announcement on 3 December 2014. This interacts with subparagraphs (3) and (4) so

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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.
71. Subparagraphs 7(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.
72. Paragraph 8 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.
73. Paragraph 9 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**

74. This new Part was announced for the first time at Autumn Statement 2014.
75. 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.
76. 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.
77. 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.