



# Finance Act 2005

## 2005 CHAPTER 7

### PART 2

#### INCOME TAX, CORPORATION TAX AND CAPITAL GAINS TAX

### CHAPTER 9

#### INTERNATIONAL MATTERS

##### *Double taxation relief: general*

#### **85 Dividends by reference to which a deduction is allowed: no underlying tax**

- (1) In section 799 of ICTA (computation of underlying tax) after subsection (2) insert—
- “(2A) No underlying tax shall be taken into account under subsection (1) above in the case of a dividend if, under the law of any territory outside the United Kingdom, a deduction is allowed to a resident of that territory in respect of an amount determined by reference to the dividend.”.
- (2) The amendment made by this section has effect in relation to dividends paid on or after 16th March 2005.

##### *Double taxation relief: restrictions*

#### **86 Limits on credit: income tax and corporation tax: trading profits**

- (1) For sections 798 to 798B of ICTA (double taxation relief: foreign interest and dividends) substitute—

---

*Status: This is the original version (as it was originally enacted).*

---

**“798 Section 796: trade income**

- (1) This section has effect in relation to the application of section 796(1) to the allowance of credit for foreign tax against income tax in respect of trade income.
- (2) In making the computations required by section 796(1)(a) and (b) there shall be deducted from the amount of the income in respect of which the credit is to be allowed deductions, charges or expenses which would be allowable in a computation of the taxpayer’s liability in respect of that income.
- (3) The reference in subsection (2) to allowable deductions, charges or expenses includes a reference to a reasonable apportionment of allowable deductions or expenses which relate partly to the income and partly to other matters.
- (4) Where royalties (as defined in arrangements having effect by virtue of section 788) are paid in respect of an asset in more than one jurisdiction outside the United Kingdom, for the purposes of section 796(1)—
  - (a) royalty income arising in different jurisdictions (other than the United Kingdom) in a year of assessment in respect of that asset shall be treated as a single item of income, and
  - (b) credits available for foreign tax in respect of the royalty income shall be aggregated accordingly.
- (5) In this section “trade income” means income chargeable to tax under—
  - (a) Chapter 2 or 18 of Part 2 of ITTOIA 2005 (trade profits and post-cessation receipts),
  - (b) Chapter 3 or 10 of Part 3 of ITTOIA 2005 (profits of property businesses and post-cessation receipts), or
  - (c) Chapter 11 of Part 3 of ITTOIA 2005 (overseas property income).

**798A Section 797: trade income**

- (1) This section has effect in relation to the application of section 797(1) to the allowance of credit for foreign tax against corporation tax in respect of trade income.
- (2) The reference in section 797(1) to the relevant income or gain shall be treated as referring only to income arising or gains accruing out of the transaction, arrangement or asset in connection with which the credit for foreign tax arises.
- (3) In determining for the purposes of section 797(1) the amount of corporation tax attributable to any income or gain, there shall be taken into account—
  - (a) deductions or expenses which would be allowable in the computation of the taxpayer’s liability,
  - (b) a reasonable apportionment of allowable deductions or expenses which relate partly to the transaction, arrangement or asset from which the income or gain arises and partly to other matters, and
  - (c) expenses of a company connected (within the meaning given by section 839) with the taxpayer, in so far as reasonably attributable to the income or gain.

---

*Status: This is the original version (as it was originally enacted).*

---

- (4) In this section and section 798B “trade income” means—
- (a) income or profits chargeable to tax under Case I, II or V of Schedule D,
  - (b) profits of a Schedule A business computed in same way as the profits of a trade in accordance with section 21A of ICTA,
  - (c) sums charged to tax under Case VI of Schedule D in accordance with section 104 of ICTA, and
  - (d) any other income or profits which by a provision of ICTA is chargeable to tax under, or computed in accordance with, Case I of Schedule D;
- but this section shall not apply in relation to income to which section 804C below applies.

#### **798B Section 798A: special cases**

- (1) Where—
- (a) a credit for foreign tax arises in connection with an asset, and
  - (b) the asset is in a hedging relationship with a derivative contract,
- in the application of section 798A(2) the reference to the income arising out of the asset shall be taken as a reference to the income arising out of the asset and the derivative contract taken together (but taking account of the income or loss from the derivative contract only in so far as reasonably attributable to the hedging relationship).
- (2) For the purposes of subsection (1)(b) an asset is in a hedging relationship with a derivative contract if—
- (a) the asset is acquired as a hedge of risk in connection with the contract, or
  - (b) the contract is entered into as a hedge of risk in connection with the asset;
- and if an asset or a contract is wholly or partly designated as a hedge for the purposes of a person’s accounts, that shall be conclusive for the purpose of this subsection.
- (3) Where royalties (as defined in arrangements having effect by virtue of section 788) are paid in respect of an asset in more than one jurisdiction outside the United Kingdom, for the purposes of section 798A(2)—
- (a) royalty income arising in more than one jurisdiction (other than the United Kingdom) in a year of assessment in respect of that asset shall be treated as income arising from a single transaction, arrangement or asset, and
  - (b) credits available for foreign tax in respect of the royalty income shall be aggregated accordingly.
- (4) If a person (“A”) carrying on a trade giving rise to trade income enters into a scheme or arrangement with another person (“B”) a main purpose of which is to alter the effect of section 798A in relation to A, income received in pursuance of the scheme or arrangement shall be treated for the purposes of section 798A as trade income of B (and not as income of A).
- (5) Where—

---

*Status: This is the original version (as it was originally enacted).*

---

- (a) transactions, arrangements or assets are treated by a taxpayer as a series or group (the “portfolio”),
- (b) a number of credits for foreign tax arise in respect of the portfolio, and
- (c) either—
  - (i) it is not reasonably practicable to prepare a separate computation of income or gain for the purposes of section 798A(2) in respect of each transaction, arrangement or asset, or
  - (ii) a separate computation of income or gain in respect of each transaction, arrangement or asset for the purposes of section 798A(2) would not, compared with an aggregated computation, make a material difference to the amount of credit for foreign tax which is allowable,

the income or gains arising from the portfolio, or part of the portfolio, may be aggregated and apportioned for the purposes of section 798A(2) in a fair and reasonable manner.

#### **798C Disallowed credit: use as deduction**

- (1) This section applies where the application of section 796(1) or 797(1) prevents an amount of credit for foreign tax from being allowable against income tax or corporation tax.
- (2) The amount of disallowed credit may be taken into account as a deduction in computing the taxpayer’s liability for income tax or corporation tax, but only in so far as it does not exceed the amount of any loss attributable to the income or gain in respect of which the foreign tax was paid (for which purpose payment of the foreign tax is to be taken into account, despite section 795(2)).”
- (2) In section 803 of ICTA (underlying tax reflecting interest on loans)—
  - (a) in subsection (1)(d) for “section 798” substitute “section 798A”, and
  - (b) subsections (4) to (9) shall cease to have effect.
- (3) Subsections (1) and (2) shall have effect—
  - (a) for the purposes of corporation tax, in relation to a credit for foreign tax which relates to—
    - (i) a payment of foreign tax on or after 16th March 2005, or
    - (ii) income received on or after that date in respect of which foreign tax has been deducted at source, and
  - (b) for the purposes of income tax, in relation to a credit for foreign tax which relates to—
    - (i) a payment of foreign tax on or after 6th April 2005, or
    - (ii) income received on or after that date in respect of which foreign tax has been deducted at source.
- (4) In subsection (3) a reference to tax deducted at source is a reference to tax deducted or treated as deducted from income, or treated as paid in respect of income.
- (5) In respect of dividends paid before 1st January 2006, the effect of section 798 or 798A of ICTA in respect of credit for foreign tax shall be disregarded to the extent that it would otherwise reduce the allowable credit to less than 50% of the foreign tax; but

this subsection shall not apply to tax paid as part of a scheme or arrangement designed or entered into for the purposes of causing this subsection to apply.

## **87 Schemes and arrangements designed to increase relief**

(1) After section 804 of ICTA insert—

### **“804ZA Schemes and arrangements designed to increase relief**

- (1) If the Board consider, on reasonable grounds, that conditions A to D are or may be satisfied in relation to any income or chargeable gain taken or to be taken into account for the purposes of determining a person’s liability to tax in a chargeable period, they may give the person a notice under this section.
- (2) Condition A is that, in the case of the person, there is in respect of the income or gain an amount of foreign tax for which, under any arrangements, credit is allowable against United Kingdom tax for that chargeable period.
- (3) Condition B is that there is a scheme or arrangement the main purpose, or one of the main purposes, of which is to cause an amount of foreign tax to be taken into account in the case of the person for that chargeable period.
- (4) Condition C is that the scheme or arrangement is a prescribed scheme or arrangement.
- (5) Condition D is that the amount referred to in subsection (6) is more than a minimal amount.
- (6) The amount is the aggregate of—
  - (a) the aggregate amount of the claims for credit that the person has made, or is in a position to make, for the chargeable period; and
  - (b) for all the persons connected to that person, the aggregate amount of the claims for credit that the connected person has made, or is in a position to make, for a corresponding chargeable period.
- (7) A chargeable period of a person (“A”) corresponds to a chargeable period of another person (“B”) if at least one day of A’s chargeable period falls within B’s chargeable period.
- (8) A notice under this section is a notice—
  - (a) informing the person of the Board’s view under subsection (1),
  - (b) specifying the chargeable period in relation to which the Board formed that view,
  - (c) if the amount of foreign tax considered by the Board to satisfy condition B is an amount of underlying tax, specifying the body corporate resident in a territory outside the United Kingdom whose payment of foreign tax is relevant to that underlying tax, and
  - (d) informing the person that as a consequence section 804ZB has effect in relation to him.
- (9) A notice under this section may specify the adjustments of a person’s tax return that, in the view of the Board, fall to be made by him under section 804ZB(2).

---

*Status: This is the original version (as it was originally enacted).*

---

- (10) The adjustments specified may, in a case where the notice given to a person specifies a body corporate resident outside the United Kingdom, include treating the body corporate as having paid or being liable to pay only so much foreign tax as would have been allowed to it as a credit if it were resident in the United Kingdom and a notice under this section had been given to it as regards an amount of foreign tax.
- (11) Schedule 28AB makes provision about what constitutes a prescribed scheme or arrangement.
- (12) In this section and sections 804ZB and 804ZC “tax return” means—
- (a) a return under section 8, 8A or 12AA of the Management Act, or
  - (b) a company tax return;
- and “company tax return” means the return required to be delivered pursuant to a notice under paragraph 3 of Schedule 18 to the Finance Act 1998, as read with paragraph 4 of that Schedule.

**804ZB Effect of notice under section 804ZA**

- (1) This section applies in relation to a person if—
- (a) a notice under section 804ZA has been given to the person in respect of a chargeable period specified in the notice, and
  - (b) the chargeable period specified is a chargeable period in relation to which conditions A to D of section 804ZA are satisfied.
- (2) The person must in his tax return for the period make (or must amend his return for the period so as to make) such adjustments as are necessary for counteracting the effects of the scheme or arrangement in that period that are referable to the purpose referred to in condition B of section 804ZA.

**804ZC Notices under section 804ZA: further provision**

- (1) Subsection (2) applies if the Board give a notice to a person under section 804ZA before the person has made his tax return for the chargeable period specified in the notice.
- (2) If the person makes a tax return for that period before the end of the period of 90 days beginning with the day on which the notice is given, he may—
- (a) make a tax return that disregards the notice, and
  - (b) at any time after making the return and before the end of the period of 90 days, amend the return for the purpose of complying with the notice.
- (3) If a person has made a tax return for a chargeable period, the Board may only give him a notice under section 804ZA in relation to that period if a notice of enquiry has been given to him in respect of his tax return for that period.
- (4) After any enquiries into the person’s tax return for that period have been completed, the Board may only give him a notice under section 804ZA in relation to that period if the requirements in subsections (5) and (7) are satisfied.

---

*Status: This is the original version (as it was originally enacted).*

---

- (5) The first requirement is that at the time the enquiries were completed, the Board could not have been reasonably expected, on the basis of the information made available to them or to an officer of theirs before that time, to have been aware that the circumstances were such that a notice under section 804ZA could have been given to the person in relation to that period.
- (6) For the purposes of subsection (5)—
- (a) section 29(6) and (7) of the Management Act (information made available) applies as it applies for the purposes of section 29(5), and
  - (b) paragraph 44(2) and (3) of Schedule 18 to the Finance Act 1998 applies as it applies for the purposes of paragraph 44(1).
- (7) The second requirement is that—
- (a) the person was requested to produce, provide or furnish information during an enquiry into the return for that period, and
  - (b) if the person had duly complied with the request, the Board could have been reasonably expected to give the person a notice under section 804ZA in relation to that period.
- (8) If a person is given a notice under section 804ZA in relation to a chargeable period after having made a tax return for that period, the person may amend the return for the purpose of complying with the notice at any time before the end of the period of 90 days beginning with the day on which the notice is given.
- (9) If the notice under section 804ZA is given to the person after he has been given a notice of enquiry in respect of his tax return for the period, no closure notice may be given in relation to his tax return until—
- (a) the end of the period of 90 days beginning with the day on which the notice under section 804ZA is given, or
  - (b) the earlier amendment of the return for the purpose of complying with the notice.
- (10) If the notice under section 804ZA is given to the person after any enquiries into the return for the period are completed, no discovery assessment may be made as regards the income or chargeable gain to which the notice relates until—
- (a) the end of the period of 90 days beginning with the day on which the notice under section 804ZA is given, or
  - (b) the earlier amendment of the return for the purpose of complying with the notice.
- (11) Subsections (2)(b) and (8) do not prevent a person’s tax return for a chargeable period becoming incorrect if—
- (a) a notice under section 804ZA is given to the person in relation to that period,
  - (b) the return is not amended in accordance with subsection (2)(b) or (8) for the purpose of complying with the notice, and
  - (c) the return ought to have been so amended.
- (12) In this section—
- “closure notice” means a notice under—

---

*Status: This is the original version (as it was originally enacted).*

---

- (a) section 28A or 28B of the Management Act, or
  - (b) paragraph 32 of Schedule 18 to the Finance Act 1998;  
“discovery assessment” means an assessment under—
    - (a) section 29 of the Management Act, or
    - (b) paragraph 41 of Schedule 18 to the Finance Act 1998;  
“notice of enquiry” means a notice under—
      - (a) section 9A or 12AC of the Management Act, or
      - (b) paragraph 24 of Schedule 18 to the Finance Act 1998.”
- (2) Schedule 5 (which contains a Schedule to be inserted after Schedule 28AA to ICTA) has effect.
- (3) This section and Schedule 5 have effect in relation to a credit for foreign tax which relates to—
- (a) a payment of foreign tax on or after the commencement date, or
  - (b) income received on or after the commencement date in respect of which foreign tax has been deducted at source.
- (4) In subsection (3) a reference to tax deducted at source is a reference to tax deducted or treated as deducted from income, or treated as paid in respect of income.
- (5) In subsection (3) “the commencement date” means—
- (a) so far as the amount of the credit for foreign tax is affected by a scheme or arrangement to which paragraph 5 of Schedule 28AB to ICTA (as inserted by Schedule 5) applies, 10th February 2005, and
  - (b) so far as the amount of the credit for foreign tax is affected by any other prescribed scheme or arrangement (within the meaning of Schedule 28AB), 16th March 2005.

## **88 Self-assessment amendments**

- (1) In section 9A of TMA 1970 (notice of enquiry), in subsection (4) (matters to which an enquiry extends) after paragraph (b) insert—
- “(c) consideration of whether to give the taxpayer a notice under section 804ZA of the principal Act (schemes and arrangements designed to increase relief).”
- (2) In section 29 of TMA 1970 (assessment where loss of tax discovered), after subsection (7) insert—
- “(7A) The requirement to fulfil one of the two conditions mentioned above does not apply so far as regards any income or chargeable gains of the taxpayer in relation to which the taxpayer has been given, after any enquiries have been completed into the taxpayer’s return, a notice under section 804ZA of the principal Act.”
- (3) In Schedule 18 to FA 1998 (company tax returns, assessments, etc), in paragraph 25(1) (scope of enquiry) after “medium-sized enterprise” insert “or a notice under section 804ZA of the Taxes Act 1988 (schemes and arrangements designed to increase relief)”.
- (4) In paragraph 42 of that Schedule (restrictions on power to make discovery assessment etc), after sub-paragraph (2) insert—



*Status: This is the original version (as it was originally enacted).*

“(2A) Those restrictions, other than the restriction in paragraph 45, do not apply so far as regards any income or chargeable gains of the company in relation to which the company has been given, after any enquiries have been completed into the return, a notice under section 804ZA of the Taxes Act 1988.”

(5) The amendments made by this section have effect in accordance with section 87(3).

### *Controlled foreign companies*

## **89 ADP dividends and double taxation relief**

(1) Section 801 of ICTA (dividends paid between related companies: relief for UK and third country taxes) is amended as follows.

(2) In subsection (2A) (restriction on cases where section 799(1)(b) applies for the purposes of section 801(2)) after paragraph (a) insert—

“(aa) if the overseas company is an ADP controlled foreign company as respects any of its accounting periods and the dividend mentioned in subsection (1) above is an ADP dividend of that company (in which case see also subsection (2B)); or”.

(3) After subsection (2A) insert—

“(2B) In any case falling within subsection (2A)(aa) above, section 799(1)(b) applies for the purposes of subsection (2) above as if for section 799(1A) there were substituted—

“(1A) The formula is—

$$\frac{D}{1 - X} \times X$$

where—

D is the amount of the dividend; and

X is the maximum relievable rate, expressed as a decimal fraction;

and for the purposes of this subsection the maximum relievable rate is the rate of corporation tax in force when the dividend was paid.”.

(4) After subsection (5) insert—

“(6) For the purposes of this section—

(a) a controlled foreign company is an “ADP controlled foreign company” as respects any of its accounting periods if, by virtue only of section 748(1)(a), no apportionment under section 747(3) falls to be made as respects that accounting period;

(b) an “ADP dividend” of a controlled foreign company is a dividend by virtue of which the controlled foreign company is an ADP controlled foreign company as respects any of its accounting periods.

(7) In this section—

---

*Status: This is the original version (as it was originally enacted).*

---

“accounting period”, in relation to a controlled foreign company, has the same meaning as in Chapter 4 of Part 17 (see section 751);

“controlled foreign company” has the same meaning as in Chapter 4 of Part 17 (see section 747(2)).”.

- (5) The amendments made by this section have effect where the dividend mentioned in section 799(1) of ICTA is paid on or after 2nd December 2004 and is, or represents, in whole or in part an ADP dividend of an ADP controlled foreign company.

## **90 Foreign taxation of group as single entity: exclusion of ADP CFCs**

- (1) Section 803A of ICTA is amended as follows.

- (2) After subsection (1) (company resident in territory outside the UK paying tax in respect of one or more other companies resident in that territory) insert—

“(1A) Where—

- (a) a company is (within the meaning of section 801) an ADP controlled foreign company as respects any of its accounting periods, and
- (b) the whole or any part of the profits or gains of that accounting period are included in the aggregate profits, or aggregate profits or gains, mentioned in subsection (1) above,

subsection (2) below shall have effect as if the companies mentioned in subsection (1) above did not include that company.”.

- (3) The amendment made by this section has effect in relation to dividends paid on or after 16th March 2005.

### *Annual payments and double taxation relief*

## **91 Tax avoidance involving annual payments and double taxation relief**

- (1) ICTA is amended as follows.

- (2) In section 125 (annual payments for non-taxable consideration) in subsection (2) (payments to which the section applies) for paragraph (b) substitute—

“(b) is made under a liability incurred for consideration in money or money’s worth all or any of which—

- (i) consists of, or of the right to receive, a dividend, or
- (ii) is not required to be brought into account in computing for the purposes of income tax or corporation tax the income of the person making the payment.”.

- (3) As from 2nd December 2004, the title of that section accordingly becomes “Annual payments for dividends or non-taxable consideration”.

- (4) Section 801 (dividends paid between related companies: relief for UK and third country taxes) is amended as follows.

- (5) In subsection (2) (case where overseas company has received a dividend from a third company) for “subject to subsections (4) to (4D)” substitute “subject to subsection (4)”.

---

*Status: This is the original version (as it was originally enacted).*

---

- (6) Subsections (4A) to (4D) (which relate to cases where the amount given by the formula in section 799(1) exceeds U in that formula) shall cease to have effect.
- (7) The amendment made by subsection (2) has effect in relation to any annual payment made on or after 2nd December 2004 (whether the contract or other arrangement is one made before, on or after that date).
- (8) The amendments made by subsections (4) to (6) have effect in relation to dividends paid on or after 2nd December 2004.