Finance Act 2005

2005 CHAPTER 7

PART 2

INCOME TAX, CORPORATION TAX AND CAPITAL GAINS TAX

CHAPTER 9

INTERNATIONAL MATTERS

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—

"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.

(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—

(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.