These notes refer to the Finance Act 2009 (c.10) which received Royal Assent on 21 July 2009

FINANCE ACT 2009

EXPLANATORY NOTES

INTRODUCTION

Section 60: Double Taxation Relief Anti-Fragmentation

Summary

1. Section 60 amends two of the rules contained in legislation introduced in Finance Act 2005 to limit the credit for foreign tax paid on trade receipts of a bank or a company associated with a bank to no more than the corporation tax arising on the relevant part of the trade profits. The clause ensures that, in calculating the amount of double taxation relief (DTR) available, a) a reasonable proportion of a bank's notional funding costs over all its transactions must be deducted, and that this cannot be avoided by the bank allocating a specific source of funds to specific transactions and b) clarifies the existing legislation that prevents banks avoiding the intention of the DTR legislation by artificially arranging for income to be received by a non–banking company in the bank's group.

Details of the Section

2. Subsections (1) and (2) amend section 798A of the Income and Corporation Taxes Act 1988 (ICTA) by introducing after section 798(3) new subsections (3A), (3B) and (3C) to limit the amount of the DTR for foreign tax paid on trade receipts.

3. The new subsection (3A) applies new subsection (3B) to banks and companies connected with banks which have not taken into account a reasonable apportionment of their funding costs in calculating their allowable double taxation relief.

4. Subsection (3B) requires that the allowable deductions and expenses, a reasonable apportionment of which is required to be deducted under section 798A(3) (a), (b) and (c), include a bank's notional funding costs.

5. Subsection (3) defines the expressions used in subsections (3A) and (3B).

6. Subsections (3) and (4) amend section 798B of ICTA by inserting after section 798B(4) new subsections (4A), (4B) and (4C). These subsections will ensure that where there is an avoidance scheme which arranges for an item of income to be received by an investment company for the purpose of avoiding the effect of section 798A, then provided it is reasonable to suppose that the receipt would have been a trade receipt if it had been received by a connected company, it will be treated as trading income for the purposes of calculating DTR.

7. The amendments will have effect in relation to credits for foreign tax which relate to payments of foreign tax or income received in respect of which foreign tax has been deducted on or after 22nd April 2009.

Background Note

8. Section 798A of ICTA alters the way that section 797(1) limits the allowance of credit for foreign tax against corporation tax in respect of trade income. It limits the amount

of the credit for foreign tax paid on trade receipts to no more than the corporation tax arising on the relevant part of the trade profits.

9. It does this by requiring companies to deduct direct expenses and a reasonable proportion of their allowable deductions and expenses which include overheads when calculating the amount of profit attributable to the foreign tax and hence the amount available to credit against their corporation tax.

10. Where the taxpayer is not a bank or a company connected with a bank, there is no change to the existing legislation but the new legislation puts it beyond doubt that banks and companies connected with banks will be required to include their funding costs within these deductions and expenses.

11. The existing section 798B(4) counters the use of avoidance schemes by banks which attempt to avoid the requirement to deduct overheads and expenses by artificially diverting trading income into investment subsidiaries which are not subject to the same requirement. The new clause clarifies the existing rule and puts it beyond doubt that from 22 April 2009, where there is an avoidance scheme or arrangement, any item of income which it is reasonable to assume would be trade income if received by a bank will be treated as trade income of the investment subsidiary.