In this chapter we look at when profits and losses of overseas PEs can be exempt for UK tax purposes including:
- the election for exemption;
- the foreign permanent establishment amount;
- capital allowances;
- application to capital gains;
- rules for losses and streaming;
- anti-diversion rules.

11.1 Introduction

You will recall from the chapter on Double Tax Treaties that a PE is not a separate entity in its own right, but is part of a company resident in another territory, in this case the UK. The concept of a PE is a fiction for tax purposes, which enables the country in which the profits arise to tax those profits, as well as the country in which the company itself is resident. The concept is defined in Article 5 of the OECD Model Treaty.

Where a UK company is held to have a PE in another jurisdiction under a tax treaty, both the UK and the other jurisdiction have the right in principle to tax its profits. In order to avoid the same profits being taxed twice, the UK will give double tax relief in respect of the profits of the overseas PE. The two methods of giving double tax relief are by allowing a credit against the UK tax due on those profits for any overseas tax paid, or by exempting the profits from UK tax altogether.

We have seen in an earlier chapter how the credit system works for the profits of an overseas PE of a UK company.

The Finance Act 2011 introduced a new regime for double taxation relief for overseas PEs. The new regime allows companies to elect to replace the ‘tax with credit’ system with a simpler exemption system. CTA 2009, s.18A

11.2 The Election

The election should specify the accounting periods to which the election will apply (e.g. “the accounting period commencing on ... and all subsequent accounting periods”). The election must be received by HMRC before the start of the first period that it relates to. If the election is made before the company’s first accounting period, then that is the first exempt period.

As from 1 January 2013, a non-UK resident company can make the election in relation to a future accounting period when it will be UK resident.

The election must be signed by a responsible officer of the company.

The election may optionally also specify one or more territories that will be "streamed" for the purposes of the transitional rule, as we shall see when we look at losses below.
The election may be withdrawn at any time until the start of the first accounting period to which it relates. After that time it becomes **irrevocable**. The election is automatically revoked if the company ceases to be UK resident.  **CTA 2009, s.18F**

The election affects all the PEs of the company; the company is not allowed to pick and choose which PEs are exempt.

There is no special form for the election and no prescribed wording, but its meaning must be made clear and it must include an unambiguous and accurate specification of the accounting periods to which it will relate. The provisions found at Sch 1A TMA 1970 with regard to claims not included in a return will apply to such an election.  **FA 1998, Sch 18 Para 58**

A company may elect into exemption at a time when it has no foreign PEs. The election will have no effect until the company holds a foreign PE, but it will then become irrevocable in the same way as an election made by a company with a foreign PE.

An election **does not have effect for a small company unless the PE is in a full treaty territory**. A full treaty territory is one with which the UK has a double tax convention and it includes a non-discrimination clause.  **CTA 2009, s.18P**

The exemption does not extend to profits or losses arising to a branch as lessor under a plant or machinery lease, where the company in question or a company connected with it have benefited from capital allowances in respect of expenditure on the provision of the plant or machinery in question.  **CTA 2009, s.18C(3)**

The exemption also **does not extend to profits or losses** referable to a transaction where a **UK resident would have been obliged to withhold tax** from any payments under the transaction had it been making those payments to a company resident in the territory in which the PE is located, and no refund of that withholding tax would have been available to the non-UK resident company under the applicable treaty.  **CTA 2009, s.18D**

For accounting periods beginning on or after 1 January 2013, any profits or losses from the company's business which consists in the making of investments are excluded from exemption. However, if such profits or losses are generated from assets which are effectively connected (as defined within the OECD model treaty) with that part of the PE which carries out a trade or overseas property business, then they can be included in the exemption adjustment calculation. Therefore if an **overseas PE carries on only investment business**, none of its profits or losses will be able to benefit from the exemption.  **CTA 2009, s.18CB**

### 11.3 The Foreign Permanent Establishments Amount

Once the election is made, the tax computations of a company are adjusted by 'exemption adjustments' so as to exclude the 'foreign permanent establishments amount'. This is defined as the aggregate of the ‘relevant profits amount’ in the case of each foreign territory, less the aggregate of the ‘relevant losses amount’ in the case of each foreign territory. Thus the **results of all overseas PEs are aggregated**.  **CTA 2009, s.18A**

The ‘**relevant profits amount**’ which makes up the exempt PE profits is defined as those **profits which are attributable to a PE for the purpose of establishing entitlement to credit relief in respect of any foreign tax.** This does not mean that
any foreign tax needs to have been paid, but it is necessary that the profits would be attributable for credit relief purposes.

The attribution must be made in accordance with a treaty. Where the UK has a full treaty in place with the PE jurisdiction, the attribution is to be made in accordance with that treaty. If there is no full treaty in place, the exempt profits are those that would be attributed to the PE if a treaty was in place that is identical to the 2010 OECD Model Convention.

The ‘relevant losses amount’ is defined by reference to the same rules and principles as are applicable to the calculation of the ‘relevant profits amount’.

Essentially applying the treaty rules means using the distinct and separate enterprise principle outlined in the chapter on the determination and taxation of the UK source income of non-UK resident corporations.

11.4 Capital Allowances

Once an election under CTA 2009, s.18A has been made, no actual capital allowances can be claimed by the company in respect of any past capital expenditure on assets being used for the purposes of PE activity.  CTA 2009, s.18C

Once a PE is exempt it is treated as a separate activity not within the charge to tax and so a ‘non-qualifying activity’ for capital allowances purposes. As from 1 January 2013 this does not apply where the profits and losses are excluded from the exemption where the company is a lessor of plant and machinery.  CAA 2001, s.15(2A)&(2B)

Instead notional capital allowances are given in calculating the exempt profits of the overseas PE. In order to do this, when a PE becomes exempt there is a disposal event – the value is then used as the starting point for the notional capital allowances. The general rule is that each asset is treated as being transferred to the PE at its ‘transitional value’, which is its TWDV.  CAA 2001, s.62A(3)

However, for some plant or machinery, the normal disposal value (typically market value) will be brought into account for capital allowance purposes at the date of transition.  CAA 2001, s.62A

This will happen in two cases:

i. if the asset, or group of assets, has a historic cost greater than £5 million, and the company has used (or is treated as if it had used) the plant or machinery other than for the purposes of the foreign PE activity at any time in the 6 years prior to the first exemption period, excluding any accounting period that ends earlier than 12 months before 19 July 2011; or  CAA 2001, s.62A(4)

ii. if the asset, or group of assets, has a historic cost greater than £50 million, and the company has used (or is treated as if it had used) the plant or machinery other than for the purposes of the foreign PE activity, at any time back to 6 years before 19 July 2011.  FA 2011, Sch 13 para 36

Where a person sells an asset to the company for use in the company’s exempt PE, and does so at less than market value, then the disposal value for capital allowances purposes is increased to the market value. This is because the purchaser is not going to use the asset for a qualifying activity.  CAA 2001, s.61(4)
11.5 **Chargeable Gains**

The election covers all gains and losses attributable to overseas PEs, including those that are capital in nature. Thus exemption adjustments will need to be made in the UK company's profits to remove the effect of any gains or losses relating to capital assets of the PE. However, there may be times when this basic rule is set aside. **CTA 2009, s.18B**

The general rule will be set aside when the asset has not been held by the relevant PE for the entire period in which the asset has been held by the company in question — an adjustment is required to the capital gains calculation in order fairly to reflect the profit or loss attributable to the foreign PE.

**Note that indexation will apply as normal in the adjusted capital gains calculation. This has been ignored in the illustrations below.**

- **Illustration 1**

An asset is acquired for £50k in 2014 and used exclusively in an exempt PE until 2017 when it is transferred to be used by UK head office. At that time its market value is £200k and the other State taxes a gain of £150k. The asset continues to appreciate in value until it is sold to an unconnected company in 2022 for £450k. The gain in the corporation tax computation will be £400k, but this will be reduced to £250k by the exemption adjustment of £150k in relation to the gain in the PE arising in 2017.

The legislation does not prescribe how the adjustment is to be calculated; the above illustration is from HMRC guidance. The guidance goes on to state that:

“It is possible that another method may be adopted provided that it gives a reasonable estimate of the result determined by reference to market value. In practice it will often be appropriate to use time apportionment, unless there is reason to believe that there have been significant fluctuations in the value of the asset.”

In the illustration above market value was used but we could use time apportionment. So in the above case, the asset is held for 8 years and is used exclusively in a PE for 3 years. The gain of £400k is therefore again reduced to a chargeable gain of £250k (5/8 * £400k).

**No gain/no loss transfers**

Where an asset attributable to a PE is transferred under the no gain/no loss provisions by a company that has opted into the PE exemption, the provisions are modified to ensure an **appropriate amount of ‘exemption’ applies on the eventual sale of the asset.**

The no gain/no loss value is taken to be that which would secure neither a gain nor a loss for the transferor after taking account of the PE exemption. In simple terms this will generally be MV at date of transfer. This is so whether or not the transferee company has opted into exemption. **TCGA 1992, s.276A**

This will have the result that the amount of the no gain/no loss value will include the foreign permanent establishments amount which would be attributable to the disposal if it were not a no gain/no loss disposal. Where this PE exempt amount is a gain, then the base cost going forward (for the transferee) will be higher as it includes the PE exempt amount, and thus the final gain will be smaller.
Illustration 2

An asset costing £100k is used in the exempt PE of group company A, and is transferred to group company B when its value is £130k. TCGA 1992, s.171 applies to the transfer, and the operation of TCGA 1992, s.276A requires the no gain/no loss value to be £130k rather than £100k, as this includes the PE exempt gain of £30k.

If company B then uses the asset in the UK before disposing of it for £200k, its chargeable gain would be £70k (rather than £100k), effectively preserving the value of exemption for the transferee company – which should not be taxed on the company A PE’s exempt £30k gain.

No charge would arise in Company A (the transferor) as the £30k PE gain is exempt anyway, so the transfer is effectively at the no gain/no loss amount of £100k.

Close Company Exclusion

Another circumstance in which the general rule is set aside is in relation to chargeable gains realised by a PE of a close company. These gains are precluded from qualifying for the exemption. This makes sense, given that TCGA 1992, s.13 imputes to the shareholders of a non-UK resident close company certain chargeable gains made by that company. CTA 2009, s.18P

Rollover Relief

If an asset has been partly used by an overseas PE and a claim for rollover relief under TCGA 1992, s.152 is made on reinvestment of the proceeds, adjustments need to be made to the proceeds and rollover relief claim to take account of the time the asset was used in the overseas PE. The idea is to prevent ‘rollover’ of the PE exempt gain.

TCGA 1992, s.276A requires that for the purpose of TCGA 1992, s.152 the consideration which would secure that neither a gain nor loss would accrue to the company on the disposal (i.e. which ensures no gain arises on the first disposal) includes the amount that would be the foreign permanent establishments amount attributable to the disposal. This means the exempt part of any gain is not rolled over into the base cost of the new asset, as shown in the illustration below.

Illustration 3

Legend Ltd disposes of an asset for consideration of £200k. The asset cost £50k and 30% of the asset was used for the purpose of a PE throughout the period of ownership. Legend acquires replacement assets with a total cost of £225k and a claim is made under TCGA 1992, s.152.

**Calculate the amount of gain which can be rolled over. Ignore indexation.**

There is full reinvestment under the existing rollover rules, so no gain arises on the disposal of the first asset, and the gain of £150k would be rolled over – under the ‘usual’ rules the base cost of the second asset would be £75k, being 225k – 150k.

However, in this instance we have to deal with the exempt foreign PE. The consideration received for the first asset is reduced to such an amount as would give rise to neither a gain nor a loss after taking account of the overseas PEs amount.

The gain is £150k (200k less 50k).
Part of this gain relates to the use of the asset by the PE. This overseas PE amount is £45k (30% of 150k). The rollover calculation is adjusted to take account of this gain.

The exempt part of the gain is not rolled over into the base cost of the new asset. Therefore the base cost going forward is £120k (75k as above, plus the exempt gain of 45k). A higher base cost is as expected because the £45k of gain relating to the use by the PE should be exempt.

Where the second business asset has been used in a PE but the first has not, the effect of a claim under TCGA 1992, s.152 will be to reduce the base cost of the second asset. The exemption adjustment on the disposal of the second asset should take account of this reduction (and will then be based on a gain calculation which ignores the rollover which has reduced the base cost), as shown below.

Illustration 4

Heroes Ltd sells a business asset for consideration of £400k, realising a gain of £100k.

The asset has not been used by an overseas PE.

The proceeds are applied in acquiring a new business asset that will be used in an overseas PE. The new asset cost £440k.

State how the gain on each asset will be treated for tax purposes, assuming a claim is made for rollover relief.

If a claim is made under TCGA 1992, s.152 the cost of the new asset is reduced to £340k (440k less 100k), as the gain is rolled over into the base cost of the new asset.

If we assume that some time later the new asset is disposed of for £600k, the gain will be £260k (600k less 340k). However there would be an exemption adjustment of £160k, which represents the gain made on the new asset ignoring rollover (600k less 440k) and that which would be taxable in the other State in accordance with the relevant tax treaty. There is a remaining net chargeable gain of £100k, which recovers the rolled over gain on the first asset.

There are similar rules for IFAS.

11.6 Losses and Streaming

We saw above that when a company elects to opt into the exemption regime its election becomes effective at the start of the accounting period after the one in which it makes the election. However this will not be the case where its foreign PEs are in a net loss position at the start of that period.

Under the credit system, if an overseas PE has losses then, when they are used overseas, there will be a reduction in the credit relief available in the UK (as the overseas tax bill and hence credit against UK tax will be less).

The exemption rules wish to duplicate this by deferring the time at which the exemption system will begin where a company has losses brought forward as it enters the system.
The transitional rule looks back to see what **net losses** have arisen in all the foreign PEs of the company in the **6 years prior to the first accounting period** for which the election for exemption has been made.

Where there are net losses that have not been matched by subsequent profits in that period, there will be a “loss carried forward” at the end of the accounting period just prior to the first accounting period for which the election for exemption has been made. Chargeable gains and losses are ignored in arriving at that amount. It is called the **total opening negative amount**.

It does not matter whether the net PE losses in question have been set-off sideways (e.g. against profits of the UK part of the company) carried back, or surrendered as group relief. The computation proceeds as if they are always carried forward.

### Illustration 5

The overseas PE of Manta Ltd has the following results for the 6 years before the election is to operate.

<table>
<thead>
<tr>
<th>Year</th>
<th>Profit / (loss)</th>
<th>Loss c/f (if any)</th>
</tr>
</thead>
<tbody>
<tr>
<td>-6</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td>-5</td>
<td>-100</td>
<td>100</td>
</tr>
<tr>
<td>-4</td>
<td>300</td>
<td>0</td>
</tr>
<tr>
<td>-3</td>
<td>-500</td>
<td>500</td>
</tr>
<tr>
<td>-2</td>
<td>100</td>
<td>400</td>
</tr>
<tr>
<td>-1</td>
<td>100</td>
<td>300</td>
</tr>
</tbody>
</table>

Calculate the total opening negative amount.

In this case, the total opening negative amount is 300.

You will note only losses are carried forward in this calculation (not profit amounts).

This is matched to the total PE profits in the years following the period of the election until it is used up. Then the exemption can start.

There is a special rule where the pre-commencement losses are ‘large’ in an accounting period beginning within the period of 6 years ending on 18 July 2011. 

**FA 2011, Sch 13 Para 34**

A ‘large pre-commencement loss’ is defined as exceeding **£50m** in any one **territory** (i.e. the net losses of all the PEs in a particular state).

Where there has been such a relevant losses amount then the period **that is considered is not limited to the 6 years** before the election. Instead, all accounting periods are considered that begin within the 6 year period ending prior to 19 July 2011.

As noted above, where a company has an opening loss then it is to be matched against profits in future years. The period in which this takes place is called the “transitional period.” The exemption will not take effect until all the losses brought forward are matched. 

**CTA 2009, s.18K**

During this period, whilst the brought forward loss is being matched, the profits of the PE remain subject to UK corporation tax. Double Tax Relief will continue to be given under the credit system.
As the profits and losses of overseas PEs are aggregated following an election, it is only a net profit that can be set against the loss brought forward.

Any losses arising in the transitional period do not increase the opening loss.

It may be that completion of the matching process will occur part way through an accounting period, in which case the company can specify in its tax return for that period which part of its foreign PE profits will be matched with the remaining opening amount. This will enable the company to maximise the tax credit relief available in respect of the taxable profits. CTA 2009, s.18K(4)

Streaming Losses

The general rule of aggregating results of all PEs can be set aside if a company makes a streaming election. CTA 2009, s.18L

The streaming election needs to be made at the same time as the s.18A election, must state the relevant territory that is to be streamed and the opening negative amount that is to be streamed. The streamed amounts are not aggregated with the profits or losses of PEs in other territories, and they form a separate opening negative amount. This is then matched against the profits of PEs in that territory only, until it is used up. CTA 2009, s.18N

It is possible to stream any amount up to the total opening negative amount for all territories. A company does not have to stream the full amount of the loss in a territory. It is possible to stream in relation to more than one territory. The election is irrevocable in the same way as the s.18A election.

Illustration 6

A company with 4 foreign PEs elects into exemption in 2016. The profits and losses arising in the 4 territories in the preceding 6 years are as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Territory 1</th>
<th>Territory 2</th>
<th>Territory 3</th>
<th>Territory 4</th>
<th>Aggregate</th>
<th>Loss c/f</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>100</td>
<td>0</td>
<td>0</td>
<td>(500)</td>
<td>(400)</td>
<td>(400)</td>
</tr>
<tr>
<td>2012</td>
<td>200</td>
<td>(200)</td>
<td>(100)</td>
<td>100</td>
<td>0</td>
<td>(400)</td>
</tr>
<tr>
<td>2013</td>
<td>(100)</td>
<td>(500)</td>
<td>200</td>
<td>100</td>
<td>(300)</td>
<td>(700)</td>
</tr>
<tr>
<td>2014</td>
<td>300</td>
<td>200</td>
<td>100</td>
<td>(100)</td>
<td>500</td>
<td>(200)</td>
</tr>
<tr>
<td>2015</td>
<td>100</td>
<td>(1000)</td>
<td>(200)</td>
<td>(100)</td>
<td>(1200)</td>
<td>(1400)</td>
</tr>
<tr>
<td>2016</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>400</td>
<td>(1000)</td>
</tr>
<tr>
<td>Total</td>
<td>700</td>
<td>(1400)</td>
<td>(100)</td>
<td>(400)</td>
<td>(1000)</td>
<td>(1000)</td>
</tr>
<tr>
<td>ONA</td>
<td>0</td>
<td>(1400)</td>
<td>(100)</td>
<td>(400)</td>
<td></td>
<td>(1000)</td>
</tr>
</tbody>
</table>

The ‘total’ opening negative amount for the company is 1,000.

If the company elects for territory 2 to be streamed, then the streamed loss for that territory is the lower of 1,400 or 1,000, i.e. 1,000. The company streams no other territory, so the unstreamed loss is the difference between the aggregate pool of losses 1,000 and the streamed pool 1,000, which is nil.

Therefore this company has a streamed opening loss of 1,000 for territory 2 and no other opening negative amount.

This means that the first 1,000 of profits arising in territory 2 after exemption is excluded from exemption. These profits will be matched with the streamed
opening loss. All other profits and losses in the other territories are included in exemption (and once the 1,000 has been matched, then the profits in territory 2 can also be included in the exemption).

The company could alternatively have created a streamed pool of (say) 500, in which case there would have been unstreamed losses of 500. These unstreamed losses would need to be matched with profits in the unstreamed territories and would delay the application of the exemption until they were all matched. 

CTA 2009, s.18N

Once all the streamed losses are matched then, where an unstreamed loss remains, the unmatched streamed profits are treated as unstreamed, and so can be set against the remaining unstreamed loss amount.

An advantage of streaming is that if a company has PEs in some territories which do not have brought forward losses, the exemption will not be disapplied in respect of their profits simply because of the need to offset the losses of PEs in other territories. Thus, if a company has a profitable PE in one territory, but unprofitable PEs elsewhere, streaming will allow the profitable foreign PE to gain exemption from UK corporation tax at an earlier time than would have been the case if all the losses of the unprofitable PEs had to be used up first.

Other relevant factors for a company in deciding whether or not to make a streaming election are the tax rate in each territory, and the likelihood of PEs in a particular territory being profitable in the future.

Illustration 7

Murray plc has overseas PEs in Ruritania and Utopia, and decides to make an election under s.18A for its overseas PE profits to be exempt from UK tax.

The rate of overseas tax suffered on the Ruritanian PE’s profits is 10%, while overseas tax on the Utopian PE’s profits is 25%. The Utopian PE has an opening loss of £500,000. In the first period after the election has been made, both PEs make profits of £250,000. Similar profits are anticipated for both PEs in the following period.

You are required to advise the company on whether it would be advantageous to make a streaming election.

In the absence of a streaming election, the UK tax payable on the profits of the two PEs will be as follows:

<table>
<thead>
<tr>
<th></th>
<th>Ruritanian PE</th>
<th>Utopian PE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profits</td>
<td>250,000</td>
<td>250,000</td>
</tr>
<tr>
<td>Overseas tax paid</td>
<td>25,000</td>
<td>62,500</td>
</tr>
<tr>
<td>UK corporation tax @ 20%</td>
<td>50,000</td>
<td>50,000</td>
</tr>
<tr>
<td>Less DTR</td>
<td>(25,000)</td>
<td>(50,000)</td>
</tr>
<tr>
<td>UK tax payable</td>
<td>25,000</td>
<td>Nil</td>
</tr>
</tbody>
</table>

The opening loss of £500,000 is fully matched in Year 1, so that the profits of both PEs will be exempt in Year 2.

If a streaming election had been made, the opening loss would only have been matched against the profits of the Utopian PE. The profits of the Ruritanian PE
would have been exempt from the date of entry into the regime, saving £25,000 of UK tax in Year 1.

Although the profits of the Utopian PE would remain taxable in both Years 1 and 2, the UK tax due on those profits would be fully offset by DTR, leaving no additional UK tax payable.

If, on the other hand, it had been the Ruritanian PE which had the opening loss of £500,000, the tax due in Year 1 in the absence of a streaming election would remain as set out above, and both PEs would enter the exemption regime at the beginning of Year 2.

However, if a streaming election had been made in this case, only £250,000 of the opening loss would have been matched in Year 1. A further £250,000 would be carried forward to be matched against the Ruritanian profits of Year 2, and a UK tax liability would arise in that year which was not fully offset by DTR. A streaming election in this case would thus result in an increased overall UK tax liability.

11.7 Anti-Diversion Rules

The exemption will not apply to the profits of certain PEs which are being used to divert profits out of the UK.

The exemption of PE profits is subject to a set of anti-diversion rules that reflect all aspects of the CFC rules (which are outlined in a later chapter). You will need to refer to this chapter, and to the CFC exemptions, when considering the anti-diversion rules applicable to overseas PEs for which a s18A CTA 2009 election has been made.

The starting point for the anti-diversion rule is the 'adjusted relevant profits amount', which are the profits attributable to a PE excluding any chargeable gains or losses.

Part of the adjusted relevant profits of the PE are prevented from being exempt if:

a. the profits are ‘diverted profits’, which are defined by reference to the definition of CFC chargeable profits; and CTA 2009, s.18G

b. none of the CFC exemptions apply.

To determine if the adjusted relevant profits amount includes any diverted profits, a two step process is undertaken:

1. first establish whether the company with the foreign PE (referred to as ‘Company X’) has any profits that would be CFC chargeable profits if it were not UK resident; then

2. establish whether any of these profits are attributed to the PE.

In doing the above we need to consider the CFC gateway test, and then the possible entity exemptions which might apply. To determine whether one of the CFC exemptions does apply it is necessary to look at the position as if the PE is a separate entity, a subsidiary of Company X that is resident in the PE territory, rather than part of the UK company. CTA 2009, s.18H

With regard to step 1, it is assumed Company X is a CFC resident in the PE territory, although the place or places where the company’s activities are carried out remain the same. It is further assumed that any accounting period which falls
within the PE election is the CFC accounting period, and that its total profits are the CFC’s assumed total profits for the accounting period.

In establishing whether Company X has any profits that would be CFC chargeable profits if it were not UK resident, the **CFC charge gateway needs to be applied** (except for the solo consolidation provisions at TIOPA 2010, Part 9A, Chap 8).

The gateway tests (as modified to apply to Company X) to be considered are:

- profits attributable to UK activities;
- non-trading finance profits;
- captive insurance profits;
- profits from qualifying loan relationships. *CTA 2009, s.18HA–18HE*

We will look at these in more detail later when we look at the rules on CFCs.

With regard to step 2, if it is found that there are ‘diverted profits’ after the gateway test has been applied, then the various **CFC exemptions need to be considered** with regard to the PE, as if it were a subsidiary of Company X.

The exemptions are as found at TIOPA 2010, Part 9A, chaps 11–14, as modified under CTA 2009, ss.18IA–18ID as follows:

- the excluded territories exemption;
- the low profits exemption (de minimis amount);
- the low profit margin exemption;
- the tax exemption (where the local tax is at least 75% of the corresponding UK tax).

Some of these entity level CFC exemptions refer to accounting profits, for example, the low profits exemption, with a de minimis of £50,000 for accounting profits, or £500,000 for accounting profits with non-trade income of less than £50,000. However, the modified exemptions are applied on the basis of the ‘adjusted relevant profits’ of the PE and not the PE’s accounting profits. This is because the adjusted relevant profits amount is already known in the case of the PE exemption (i.e. the relevant profits amount excluding any chargeable gains/losses), and also because of the uncertain nature of PE accounts. *CTA 2009, ss.18IA–18ID*

As for CFCs, this anti-diversion rule for the PE exemption will need to be **considered with regard to each relevant accounting period** of the exemption, which means every year the exemption is to apply to each PE.
EXAMPLES

Example 1

The table below shows the results for a company prior to making a s.18A CTA 2009 election in 2016.

<table>
<thead>
<tr>
<th>Year</th>
<th>Territory 1</th>
<th>Territory 2</th>
<th>Territory 3</th>
<th>Territory 4</th>
<th>Aggregate</th>
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<td>200</td>
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<td>(100)</td>
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<tr>
<td>2013</td>
<td>(100)</td>
<td>(700)</td>
<td>200</td>
<td>100</td>
<td>(500)</td>
</tr>
<tr>
<td>2014</td>
<td>300</td>
<td>200</td>
<td>100</td>
<td>(100)</td>
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<td>(200)</td>
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<td>100</td>
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<td>400</td>
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You are required to explain how the company may stream the losses from Territory 1.
ANSWERS

Answer 1

In order to stream the losses the company must make a streaming election at the same time that it makes its s.18A CTA 2009 election. The election must state the territory to which streaming is to be applied and the amount of the loss to be streamed.

If the company streams territory 1, then its streamed loss will be £9,700 and the unstreamed loss will be 11,300 – 9,700 = £1,600.

This means that the profits from territory 1 to be matched with the £9,700 opening loss from territory 1 will be excluded from exemption; and the first £1,600 of profits from the permanent establishments in all the other territories will also be excluded. Once the £9,700 for territory 1 is exhausted, any remaining part of the £1,600 unstreamed opening negative amount would be set against profits of territory 1 in the same way as for any other territory.