

Summary: Intervention & Options

Department /Agency: HM Treasury HM Revenue and Customs	Title: Impact Assessment of reform to the taxation of foreign branches of UK companies	
Stage: Consultation	Version: Final	Date: 21 July 2010
Related Publications: Taxation of foreign branches – a discussion document		

Available to view or download at:

http://www.hm-treasury.gov.uk/consult_taxation_of_foreign_branches.htm

Contact for enquiries: Alex Harris

Telephone: 0207 270 6104

What is the problem under consideration? Why is government intervention necessary?

The Government is committed to a more territorial approach to company taxation. Under a more territorial tax system, there would be fewer instances in which UK companies were taxed on their overseas earnings. In the case of foreign branches, moving to a regime that exempts foreign branch income from UK tax would achieve this, ensuring greater consistency of tax treatment between foreign branches and subsidiaries. The Government is aware that the options could impact different sectors in different ways. The Government is consulting both on the form of a profits exemption and on options relating to foreign branch loss relief, to ensure that the reformed regime is competitive.

What are the policy objectives and the intended effects?

The policy objectives are to enhance the competitiveness of the UK's corporate tax regime and to achieve greater alignment between the tax treatment of foreign branches and foreign subsidiaries. Further objectives for the new regime are fairness, simplicity and affordability.

What policy options have been considered? Please justify any preferred option.


The Government is currently considering an exemption for foreign branch profits. Within this broad context, there a number of options including how the foreign branch taxation regime should treat chargeable gains, how the regime should work in the case of small companies and how foreign branch losses should be treated under an exemption regime. These are all described in detail in the discussion document.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? The reforms will be monitored once they are implemented. Compliance costs are routinely reviewed 1-3 years after implementation.

Ministerial Sign-off For consultation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:



Date: 21 July 2010

Summary: Analysis & Evidence

Policy Option: Exemption regime	Description: A profits exemption for foreign branches of UK companies, with a number of possibilities for its scope. This could be combined with relief for foreign branch losses, or alternatively, could be part of election regime.
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COSTS	ANNUAL COSTS		Significant admin costs would be unlikely to arise from an exemption whether compulsory or by election. Requirements under the “claw back” options for example, would use information already produced under existing rules, and in the context of large groups fewer than 20 would be affected. In the case of an election it is estimated that 5-10 large groups would opt out, with negligible admin costs. Some small companies might also opt out.
	One-off (Transition)	Yrs	
	£ Negligible	N/A	
	Average Annual Cost (excluding one-off)		
	£ Negligible	N/A	
Total Cost (PV)			£ Negligible
Other key non-monetised costs by ‘main affected groups’ None.			

BENEFITS	ANNUAL BENEFITS		In the context of large groups, this measure is likely to affect fewer than 40-50 large UK companies holding offshore branches. These companies will still have to produce accounts for foreign jurisdictions, and commercial returns for branches. Hence, while there could be some saving on admin burdens, this is likely to be negligible.
	One-off	Yrs	
	£ Negligible	N/A	
	Average Annual Benefit (excluding one-off)		
	£ Negligible	N/A	
Total Benefit (PV)			£ Negligible
Other key non-monetised benefits by ‘main affected groups’: A key benefit of exemption is in improving alignment of tax treatment of foreign branches and subsidiaries. There will be considerable benefit to the financial sector, and especially for general insurance companies, which will have greater flexibility in seeking to structure for non-tax (including regulatory) reasons.			

Key Assumptions/Sensitivities/Risks:
None.

Price Base Year N/A	Time Period Years N/A	Net Benefit Range (NPV) £ N/A	NET BENEFIT (NPV Best estimate) £ Negligible
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What is the geographic coverage of the policy/option?		United Kingdom	
On what date will the policy be implemented?		2011	
Which organisation(s) will enforce the policy?		HMRC	
What is the total annual cost of enforcement for these organisations?		£ Absorbed	
Does enforcement comply with Hampton principles?		Yes	
Will implementation go beyond minimum EU requirements?		No	
What is the value of the proposed offsetting measure per year?		£ N/A	
What is the value of changes in greenhouse gas emissions?		£ N/A	
Will the proposal have a significant impact on competition?		No	
Annual cost (£-£) per organisation (excluding one-off)	Micro Negligible	Small Negligible	Medium Negligible
Are any of these organisations exempt?	No	No	No

Impact on Admin Burdens Baseline (2010 Prices)			(Increase – Decrease)
Increase of	£ Negligible	Decrease of	£ Negligible
Net Impact		£ Negligible	

Key:

Annual costs and benefits: Constant Prices

(Net) Present Value

Evidence Base

1. The issue

- 1.1 A foreign branch is established by a UK company if it carries on part of its trade in another foreign jurisdiction without establishing a separate trading subsidiary company there. The UK currently has a “tax-with-credit” regime, which taxes foreign branch profits and gives credit for foreign tax paid on those profits against the UK tax on the same profits. Relief for foreign branch losses is also given under the current rules, reducing the amount of a UK company’s profits that are subject to corporation tax.
- 1.2 Foreign branch trading losses can be set off against other branch or company profits or against those of other group companies under the group relief rules (subject to certain restrictions). Excess branch losses are carried forward as per normal loss carry-forward rules within the UK company holding the overseas branch(es).
- 1.3 The Government is consulting on the form of an exemption regime for foreign branch profits, to enhance the UK's competitiveness and to achieve greater consistency of tax treatment between branches and subsidiaries. Under distribution exemption, introduced in Finance Act 2009, profits distributed from a foreign subsidiary to a UK parent company are generally exempt from corporation tax.
- 1.4 A simple exemption from UK tax of foreign branch profits would also prevent relief being given for losses incurred by the branch, as in general, loss relief and profit taxation share a common scope.

2 Affected sectors

2.1 Large companies in the following sectors make significant use of branch structures:

- *Oil and gas* exploration is often conducted through foreign branches. This can be for a number of reasons, including legal and contractual obligations and filing requirements. Exploration activity routinely makes losses in its early stages, and there is a significant risk that an exploration project will not lead to a successful outcome. These characteristics make loss relief for foreign branch activity particularly important for the sector.
- *Banks* often conduct business through foreign branches. Again, this can be for a number of regulatory and commercial reasons, especially efficient allocation of capital.
- *Insurance companies* currently make significant use of branch structures. In addition, developments in prudential regulation have made the regime for foreign branch taxation a pressing issue for insurers. The Solvency II regime will modernise and consolidate prudential regulation for insurers across the EEA. This new, much more harmonised solvency regime is one factor leading many insurers to consider using branch structures where they had previously operated through subsidiaries.

2.2 The Government is aware that the regime for foreign branch taxation is a particularly important issue for multinational enterprises in these sectors. Nevertheless, the Government welcomes evidence from all sectors on the impacts of the options.

2.3 The Government is aware that changes to the regime for foreign branch taxation may also impact on some small companies and welcomes views on how changes to the rules would affect small companies.

3. Evidence on compliance impacts

- 3.1 Within an exemption regime, branches and their companies would still need to produce commercial returns for the UK and tax returns for the jurisdictions they are operating within. As a result, there is likely to be little impact on administrative burdens from exempting foreign branch income, though there is some potential for administrative saving as companies within an exemption regime will not need to claim for DTR.
- 3.2 Based on the evidence available, the Government's initial assessment in the context of large companies is that while hundreds of branches may potentially be exempted, these are held by approximately 40-50 large UK groups. However, the Government welcomes further evidence and views on administrative and wider compliance impacts, including from small companies.
- 3.3 Under the elective regime option, it is likely that a small number of groups holding foreign branches in some sectors such as oil & gas would choose to opt out of the proposed new regime. This would reduce the administrative impact of the scheme.
- 3.4 Although any new rules for "claw-back" (under the option whereby if loss relief were provided, the UK would then tax branch profits until the value of the relief were reclaimed) would create an extra accounting requirement, this would use information already routinely produced by the affected firms under the existing rules. The number of large UK companies that would be impacted is expected to be low (typically less than 20 in any one year).
- 3.5 In combination, the points above suggest that the impact of these proposals on administrative burdens could well be negligible. The consultation will be used to examine this evidence.

4. Questions

- Which of the options in the discussion document would be likely to have a significant impact on administrative burdens, and what would these impacts be?
- What other compliance cost impacts would there be?
- How would small companies be affected by the options in the discussion document?

5. Impact tests

5.1 Competition Assessment

The Government's provisional assessment is that the policy options are unlikely to have a negative impact on the capacity of any business to enter markets or to compete rigorously within them. The Government welcomes views and evidence on this from interest parties.

5.2 Small Firms Impact Test

All the options under consideration would apply to small businesses. However, the Government expects that in practice, the policy options would chiefly affect large companies. The Government seeks further views and evidence on the extent to which the options would be likely to impact on small firms.

5.3 Legal Aid

The Government's assessment is that the measures introduced will not have any implications for Legal Aid.

5.4 Sustainable Development

The Government's assessment is that the measures introduced will not have any effect on sustainable development.

5.5 Carbon Assessment

The Government's assessment is that the measures introduced will not affect carbon emissions.

5.6 Other Environment

The Government's assessment is that the measures introduced will not cause any other environmental impacts.

5.7 Health Impact Assessment

The Government's assessment is that the measures introduced will not impact on people's health.

5.8 Equality Assessments

The impact on equality groups covered by the NI Act and including disability, gender and race as covered by GB equality legislation has been considered with reference to the following criteria:

- Is there a reason to believe that people are, or could be, differently affected because of their equality group?
- Is there concern from staff/customers that the policy/activity or proposal is causing discrimination?
- Is there any concern from staff/customers that the policy/activity or proposal is damaging race relations or not taking opportunities to improve equality outcomes?

No disproportionate impact or opportunity for promotion of equality has been identified and so a full EQIA is not considered necessary.

5.9 Human Rights

The Government's assessment is that the measures introduced do not have any Human Rights Act implications. This position will continue to be monitored throughout the legislative process.

5.10 Rural Proofing

The Government's assessment is that the measures introduced will not be to the detriment of rural communities.

Specific Impact Tests: Checklist

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	Yes	No
Sustainable Development	Yes	No
Carbon Assessment	Yes	No
Other Environment	Yes	No
Health Impact Assessment	Yes	No
Race Equality	N/A	No
Disability Equality	N/A	No
Gender Equality	N/A	No
Human Rights	Yes	No
Rural Proofing	Yes	No

All the above issues have been considered as part of this impact assessment.