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Sweet & Maxwell
100 Avenue Road
Swiss Cottage
London
NW3 3PF
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Sections 30–34 and Schedules 13–14: loss provisions

Section 30: loss relief surrenderable by non-UK resident established in EEA state—group relief for UK Permanent Establishment of EEA resident companies

Section 30 of the Finance Act 2013 (FA 2013) amends section 107 of the Corporation Tax Act 2010 (CTA 2010) to reflect the decision of the Court of Justice of the European Union (CJEU) in *HMRC v Philips Electronics UK Ltd* (*Philips*).[1]

In *Philips*,[2] the CJEU had to decide whether the restrictions in section 107 CTA 2010 (previously section 402 of the Income and Corporation Taxes Act 1988) on surrenders of group relief by non-UK resident companies carrying on a trade in the UK through a UK permanent establishment were contrary to EU law. The restrictions provided that such a company could not surrender losses as group relief that were deductible from or otherwise allowable against the non-UK profits of any person. It did not matter whether or not the losses were actually used in this way. The CJEU found that this was an unlawful restriction on the freedom of establishment, because it made it less advantageous for a non-resident to establish its business in the form of a branch than in the form of a subsidiary, which was not subject to such restrictions. The court also found that the restriction could not be justified under any of the arguments advanced by the UK Government, one of which was the prevention of the double use of losses.[3]

The Government's response to this decision was contained in a consultation published on December 11, 2012, which set out proposed legislation to amend section 107 CTA 2010[4] for non-UK companies resident in EEA states with UK permanent establishments. The draft legislation did not entirely remove the previous restrictions, but limited them to circumstances where the losses were actually used outside the UK. Given the terms of the CJEU's judgment, it must be doubtful whether this is sufficient to comply with EU law as there remains a distinction between the position of a UK company (which is not subject to this restriction) and the UK branch of a non-UK company,[5] and a number of commentators[6] made this point in response to

[1] *HMRC v Philips Electronics UK Ltd* (C-18/11) [2013] STC 41 (European Court of Justice).
[2] *Philips* (C-18/11), above fn.1, [2013] STC 41.
[3] See J. Englisch, "*HMRC v Philips Electronics UK Ltd*: another contribution to EU law jurisprudence on loss relief" [2012] BTR 586 for a detailed discussion of *Philips* (C-18/11), above fn.1, [2013] STC 41.
[4] HMRC, Technical Note, *Restrictions on losses and other amounts surrenderable as group relief by non-UK resident companies* (December 11, 2012), available at: *http://www.hmrc.gov.uk/budget-updates/11dec12/1342.pdf* [Accessed August 30, 2013].
[5] Which the court determined was the relevant comparison in this case.
[6] See the public response to the Government consultation: Chartered Institute of Taxation, *Finance Bill 2013: Loss relief surrenderable by non-UK resident established in EEA State* (January 28, 2013), available at: *http://www.tax*

the consultation.[7] The Government's position was that they believed that the amended legislation would comply with EU law, and they were not prepared to see a situation where it was possible for a company to obtain the benefit of the same losses twice.[8] In the context of the current debates on multi-national tax planning and the problems of "double non-taxation", it is hardly surprising that they take this position. However it is difficult to see how it can be reconciled with the CJEU's judgment in *Philips* given that the court ruled out a justification based on the double use of losses.[9] Of course one could say that it is the CJEU, rather than the UK Government, that is out of step with international concerns relating to taxation of multi-national groups in this case.

No changes have been made to the draft legislation published in the consultation document and the amended section 107 CTA 2010 accordingly permits losses of a UK permanent establishment of an EEA resident company to be surrendered to the extent that they are not deducted from, or allowed against, non-UK profits of any person in that period.[10] The changes to section 107 CTA 2010 apply to accounting periods beginning on or after April 1, 2013.[11] Losses that arise in accounting periods that straddle April 1, 2013 must be apportioned in accordance with section 1172 CTA 2010 unless that method produces a result that is unjust or unreasonable and in such a case then the apportionment will be on a just and reasonable basis.[12]

Section 31: arrangements for transfers of companies—removing inadvertent restriction on group relief

Section 31 FA 2013 makes changes to section 156 CTA 2010 to narrow the definition of "arrangements" for the purposes of Part 5 CTA 2010 (group relief).

Section 154 CTA 2010 restricts access to group relief where there are "arrangements" in place that mean that at some point a company could cease to be a member of a group for group relief purposes.[13] According to HMRC, the purpose of section 154 CTA 2010 is "to prevent the use of loss relief where it would amount to loss buying", but it "is not intended to prevent access [to group relief] where there are legitimate commercial arrangements in place".[14] This is reflected in the exclusions from the definition of "arrangements" set out in sections 155A, 155B and 156 CTA 2010.

.org.uk/Resources/CIOT/Documents/2013/01/130128%20FB13%20Loss%20relief%20rules%20(EU%20aspects)%20-%20CIOT%20comments.pdf [Accessed August 30, 2013].

[7] Despite the fact that views on the compatibility of the proposals with EU law were specifically not sought.

[8] See the written response by David Gauke MP (Exchequer Secretary), *Clause 30—Loss relief surrenderable by non-UK resident established in EEA state* (2013), available at: *http://www.theyworkforyou.com/pbc/2013-14/FINANCE_BILL/09-0_2013-06-04a.3.3* [Accessed August 30, 2013].

[9] *Philips* (C-18/11), above fn.1, [2013] STC 41. The court's position was that it was open to the home country to impose restrictions on the use of losses in this way, but not to the UK as host country to the permanent establishment. As the UK had the taxing rights to the income generated by the permanent establishment, it also had to give effective relief for any losses.

[10] CTA 2010 s.107(6B) (as amended by FA 2013 s.30).

[11] FA 2013 s.30(7).

[12] FA 2013 s.30(8).

[13] CTA 2010 s.154(3).

[14] HMRC, Tax Information and Impact Notes, *Removing inadvertent restriction on corporate tax group loss relief* (December 11, 2012), available at: *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/179248/arrangements_for_transfers_of_companies.pdf.pdf* [Accessed August 30, 2013].

It is common for public authorities to request certain restrictions to be in place when they are contracting out their functions and there were concerns that these could amount to arrangements that could cause group relief to be inadvertently restricted.

The effect of the amendments to section 156 CTA 2010[15] is to widen the exclusion to arrangements that are a condition or requirement imposed by Ministers of the Crown, Scottish Ministers, Northern Ireland Departments and statutory bodies.[16]

This change will be welcomed by companies who operate in sectors that involve contracting with the public sector.

This change applies to accounting periods ending on or after April 1, 2013.

Section 32: change in company ownership: company reconstructions

Section 32 FA 2013 has replaced section 676 CTA 2010 in its entirety with provisions that further restrict relief for carried forward losses to a successor company following the transfer of a trade. It is described as closing a "loophole", but it will also prevent companies from using losses in certain circumstances which, from a policy perspective, should at least arguably be legitimate.

Chapter 2 of Part 14 CTA 2010 (which contains section 676) restricts relief for carried forward losses when a company carrying on a trade undergoes a change in ownership and where either: (a) within three years of that change in ownership, there is a major change in the nature or conduct of the trade; or (b) the change in ownership occurs after the company's activities in a trade become small or negligible and before any significant revival of the trade.[17] It is aimed at preventing loss buying.

Under Chapter 1 of Part 22 CTA 2010, when a trade or part of a trade is transferred between companies within common ownership, losses incurred by the transferor (or "predecessor") can be carried forward against subsequent trade profits of the transferee (or "successor") company as if the predecessor had continued to carry on the trade.[18] The amendments relate to the inter-relationship between these two sets of provisions.

Originally, section 676 CTA 2010 only restricted relief for carried forward losses if there had been a change in ownership of, and a major change in the nature or conduct of the trade by, the same company. This meant that where a company had been acquired into a group (and had undergone a change in ownership), it was possible to avoid future loss restrictions by hiving the trade out to another group company that had not undergone a change in ownership within the relevant period. The carried forward losses attributable to the trade would transfer to the successor under Chapter 1 of Part 22 CTA 2010, but a subsequent change in the nature or conduct of the trade by the successor company would not then trigger any restrictions on those losses because the successor had not itself undergone a change in ownership.

This planning has been employed for many years to deal with group reorganisations following a company acquisition. In particular, it enabled groups that centralise functions or assets within a group to use existing losses in the acquired company to shelter any gains that might be triggered

[15] As amended by FA 2013 s.31.
[16] CTA 2010 s.156(2)(b)(ii) (as inserted by FA 2013 s.31).
[17] CTA 2010 s.673.
[18] CTA 2010 s.944(3).

on the disposal of its assets to another (possibly non-UK) group company. The concern was always that such re-organisations might amount to a major change in the nature or conduct of the acquired company's trade (for example, it might go from being the owner and manager of its intellectual property (IP) which it exploits in selling products to customers, to being a licensee of the IP only following its transfer to a group IP holding company). This would have the consequence that its existing losses would be restricted in periods after the change in ownership, and therefore could not be used against gains on the disposal itself. It seems odd that a company should be prevented from using its own losses in such a way, as such arrangements cannot properly be described as loss-buying. A way of avoiding this result was, in advance of the intra-group reorganisation, to hive out the business from the acquired company into an existing group company, which prevented the restrictions from applying.

The first indication that HMRC objected to this sort of planning appeared in the "Lifting the Lid" consultation[19] published in July 2012, where, to the surprise of many advisers, it was listed as the sort of planning that might be covered in amendments to the losses hallmark in the rules on disclosure of tax avoidance schemes. Although that proposal was dropped, the substantive issue became the subject of a technical note published on March 20, 2013.[20] Given the length of time that the issue has been known about, it is unfortunate that it was not made the subject of a proper consultation. Instead, HMRC simply categorised it as a "loophole", justifying departing from their usual process for formulating tax legislation. It would clearly be possible to use the planning for transactions that did amount to tax avoidance and loss-buying, but the issue demonstrates that the rules do not currently target the mischief with sufficient precision. This should have been the subject of a proper discussion, and it is disappointing that it was not.

The effect of the new section 676 CTA 2010 is that the carry forward of losses will be restricted in accordance with Chapter 2 of Part 14 CTA 2010 following the transfer of a trade to which Chapter 1 of Part 22 CTA 2010 applies where: (a) there is a change of ownership of the successor company following the transfer of the trade[21]; or (b) there is a transfer of the trade following a change in ownership of the predecessor company[22] which, in either case, is coupled with a major change in the nature or conduct of that trade.

The amendment to section 676 CTA 2010 has effect in relation to changes of ownership that occur on or after March 20, 2013.[23]

Section 33 and Schedule 13: change in company ownership: shell companies

Section 33 and Schedule 13 to FA 2013 insert a new Chapter 5A to Part 14 CTA 2010, which extends the loss buying rules set out in Part 14 CTA 2010 so that these rules now also apply to changes of ownership of "shell companies".

[19] HMRC, *Lifting the Lid on Tax Avoidance Schemes. Consultation Document* (July 23, 2012), para.5.33, available at: *http://www.hmrc.gov.uk/avoidance/tax-avoidance-schemes.pdf* [Accessed August 30, 2013].
[20] HMRC, Technical Note, *Corporation Tax—"loss loophole closure" Rules* (March 20, 2013), available at: *http://www.hmrc.gov.uk/budget2013/ct-loss-loophole-closure-rules.pdf* [Accessed August 30, 2013].
[21] CTA 2010 s.676(2).
[22] CTA 2010 s.676(4).
[23] FA 2013 s.32(2).

Part 14 CTA 2010 previously only applied to restrict carry forward losses where a company carrying on a trade, investment business or UK property business underwent a change of ownership and certain other conditions were satisfied, which depended on the nature of the business of the company. It appears that taxpayers were taking the position that a "shell company" that does not fall within any of these categories of company was not subject to any of the restrictions on using losses following a change in ownership.

Section 33 and Schedule 13 FA 2013 plug this gap, by replicating for shell companies the rules that currently apply to companies with investment business. They introduce a new Chapter 5A to Part 14 CTA 2010, which restricts the use of non-trading loan relationship debits and deficits and non-trading losses on intangible fixed assets by shell companies following a change in ownership. The main difference from the rules for companies with investment business is that the restriction takes place automatically on the change in ownership and there is no need for it to be coupled with any major change in its business or increase in capital. For the purposes of these rules, a "shell company" is a company that is not carrying on a trade, an investment business or a UK property business.[24] The accounting period in which the change of ownership occurs is treated as two separate notional accounting periods. The first notional accounting period ends on the change in ownership of the shell company and the second notional accounting period consists of the remainder of the actual accounting period.[25] The provisions then set out how the apportionment of profits and losses between these two separate notional accounting periods should occur, but broadly the effect is to restrict the use of pre-change in ownership losses so that they can only be used against profits attributed to pre-change in ownership periods.[26]

These rules will apply to changes of ownership occurring after March 20, 2013.[27]

Section 34 and Schedule 14: transfer of deductions—transfer of deduction targeted anti-avoidance provisions

Section 34 and Schedule 14 FA 2013 insert a new Part 14A CTA 2010 which introduces two targeted anti-avoidance provisions (TAARs) to prevent the transfer of unrealised losses to unconnected third parties.

The Chancellor announced on March 20, 2013 that the Government proposed to introduce legislation having effect from March 20, 2013

> "to prevent companies entering arrangements to access, as part of a business transfer, various forms of unrealised corporation tax losses from unconnected third parties."[28]

A particular "pressure point" identified by the Government is where it is possible to dictate or predict the amount or timing of reliefs, as this can encourage tax-motivated transactions through which unconnected entities can obtain access to unrealised losses. Part of the package of measures were two new TAARs: a Deduction Transfer TAAR and a Profit Transfer TAAR,

[24] CTA 2010 s.705A (as inserted by FA 2013).
[25] CTA 2010 s.705B (as inserted by FA 2013).
[26] CTA 2010 s.705F (as inserted by FA 2013).
[27] FA 2013 Sch.13, para.3.
[28] HMRC, Technical Note, *Corporation Tax—"Targeted Loss Buying Rules"* (March 20, 2013), available at: *http://www.hmrc.gov.uk/budget2013/ct-loss-buying-rules-tech-note.pdf* [Accessed August 30, 2013].

each of which will apply only where there has been a "qualifying change" within the meaning of Chapter 16A of Part 2 of the Capital Allowances Act 2001 (CAA)[29] in relation to the company under consideration. This definition is complex, but, broadly speaking, captures a change in ownership of a company, a company becoming a member of a group, a company moving from a group into a consortium, the increase by a consortium member of its ownership of a consortium company and various changes involving companies in partnership. For the purposes of both TAARs, the company under consideration is referred to as Company C.

The aim of the Deduction Transfer TAAR was stated in the Technical Note to be to

> "deny claims for group relief and relief for trade losses against total profits in accounting periods ending on or after the date of the qualifying change in respect of certain types of deductible amounts".[30]

The intention behind the Profit Transfer TAAR is to combat the transfer of profits to Company C (or a company connected with it) "where the purpose, or one of the main purposes, of the transfer is to utilise deductible amounts".[31]

The Government issued a consultation document on March 28, 2013 containing draft legislation.[32] The draft legislation was very wide and the responses to the consultation highlighted concerns around: 1. whether the impact of the profit transfer element of the TAARs was overly restrictive; 2. whether the TAARs could inadvertently restrict group relief either within an acquired sub-group or between companies other than Company C; 3. the order of legislative precedence; and 4. whether the commencement rule operated too harshly in respect of proposed transactions before March 20, 2013. The Government acknowledged that these were valid concerns and amendments were accordingly made, and published on June 26, 2013.[33]

For both the Deduction Transfer TAAR and the Profit Transfer TAAR there is a common definition of a "deductible amount" and this will include: 1. expenses of a trade; 2. expenses of a UK property business or overseas property business; 3. expenses of management of a company's investment business; 4. non-trading loan relationship debits; and 5. non-trading intangible fixed asset debits.[34] Both the Deduction Transfer TAAR and the Profit Transfer TAAR seek to restrict "deductible amounts" in certain circumstances.

The Deduction Transfer TAAR[35] will apply to restrict a "deductible amount" if it is "highly likely" that the "deductible amount" (or any part of it) will be brought into account as a deduction after the qualifying change and the main purpose, or one of the main purposes, of the arrangements to bring about the qualifying change is for the deductible amount to be brought into account after the qualifying change. The effect of the Deduction Transfer TAAR is that neither Company C,

[29] See CAA ss.212C–212I.
[30] HMRC, Technical Note, above fn.28.
[31] HMRC, Technical Note, above fn.28.
[32] HMRC, Technical Note, *Corporation Tax—"Targeted Loss Buying Rules"—Rules, Draft Legislation, Explanatory Notes and Tax Information and Impact Note Revised Version* (March 28, 2013), available at: *http://www.hmrc.gov.uk/budget-updates/march2013/target-loss-buying.pdf* [Accessed August 30, 2013].
[33] HMRC, Technical Note, *Corporation tax—"Targeted Loss Buying Rules"* (June 26, 2013), available at: *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/209562/NC4_NC5_Transfer_of_deductions_Restrictions_on_buying_capital_allowances.pdf* [Accessed August 30, 2013].
[34] CTA 2010 s.730B (as inserted by FA 2013).
[35] CTA 2010 s.730C (as inserted by FA 2013).

nor any company connected with it, will be able to make a "relevant claim" in respect of the deductible amount. A "relevant claim" is a claim to set a trade loss against total profits under section 37 CTA 2010, or a claim for group relief. The Deduction Transfer TAAR will not restrict deductible amounts which could have been claimed in the absence of the qualifying change.

The Profit Transfer TAAR[36] will apply where there are "profit transfer arrangements" which result in an increase in the total profits of Company C (or a company connected with it) or a reduction of any loss or other amount for which relief from corporation tax could have been given to Company C (or a company connected with it). A deductible amount will be restricted where it is "highly likely" that the deductible amount (or any part of it) would otherwise be brought into account as a deduction in an accounting period ending after a qualifying change and the main purpose, or one of the main purposes, of the profit transfer arrangements is to enable the deductible amount to be used in such an accounting period. The "deductible amount" will only be restricted to the extent that it is just and reasonable.[37] This is to allow Company C to use the deductible amount against other profits arising following the qualifying change, even though it cannot use it against the profits transferred into it under the profit transfer arrangements.

The concept of "highly likely" is new to tax legislation and it will be interesting to see how the courts will interpret this. Given the expressed intention of the legislation, presumably it is referring to something sufficiently predictable and in the contemplation of the parties to the arrangements for the qualifying change that they could have had the obtaining or effective use of such a deductible amount as a main purpose of the arrangements.

Part 14 A CTA 2010 will have effect in relation to "qualifying changes" occurring on or after March 20, 2013, unless before the March 20, 2013 arrangements to bring about the "qualifying change" had either already been entered into or there was an agreement or common understanding between the parties to the arrangements that cause the "qualifying change".

Lydia Challen[*]

[36] CTA 2010 s.730D (as inserted by FA 2013).
[37] CTA 2010 s.730D(7) (as inserted by FA 2013).

Carry-forward reliefs; Corporation tax; Group relief; Loss relief; Successive owners; Tax avoidance

[*] Partner, Allen & Overy LLP.