MOORE Kingston Smith

BRANCH PROFITS EXEMPTION

The exemption

The basic rule of UK corporation tax is that a UK resident company is taxed in the UK on its worldwide profits. This includes profits of any foreign branches, with double tax relief generally being given against the UK corporation tax for any foreign tax paid on the profits of these foreign branches.

UK resident companies can elect for profits of their foreign branches to be exempt from UK corporation tax. The exemption is available, most significantly, to trading profits of foreign branches, and chargeable gains on assets used for the purposes of foreign branches. Certain profits, gains and losses, particularly those arising directly or indirectly in connection with UK land, remain outside the scope of the exemption.

A branch is, strictly, a "permanent establishment", and this will usually mean any fixed place of business of the company that is located in a foreign territory, with certain agency arrangements also being included.

Taking advantage of the branch profits exemption will usually improve a company's overall tax position where the rate of foreign tax is lower than the UK rate, because the taxation of branch profits will then be capped at the foreign tax rate.

Even where the foreign tax rate is higher than the UK rate, there may be an administrative advantage in treating the branch profits as tax exempt (instead of treating the profits as taxable in the UK and then calculating any relevant double tax relief).

Making an election

The exemption is claimed by making an election.

Elections are made on a company by company basis, so different companies in the same group may elect or not as they choose.

When an election has been made, it will apply to all accounting periods starting after the date of the election. It will also apply to all foreign branches of a company, including any branches set up subsequently.

Once an election has been made, it is irrevocable after the day on which the company's next corporation tax accounting period was expected to begin.

How the exempt branch profits are calculated

It is important to ensure that profits are allocated appropriately between the UK and the non-UK activities of any company that has elected for the branch profits exemption.

Generally, profits and losses must be allocated to a branch on the basis outlined in the relevant double tax treaty between the UK and the foreign jurisdiction concerned or, if there is no treaty, on the assumption that the Organisation for Economic Co-operation and Development (OECD) model treaty is in place. Typically, this will mean that the profits and losses allocated to a particular foreign branch will be those which the branch would have been expected to make if it were a separate entity carrying on its business at arm's length from the UK company.

Certain deductions must be taken into account at branch level when calculating the profits of the branch. For example, any capital allowances available on equipment used in an exempt branch are assumed to have been claimed by the exempt branch.

Losses

Where foreign branches of a company incurred losses in any of the six years prior to the exemption coming into effect, profits of the branches will be exempt only after the losses have been matched by subsequent branch profits.

By default, all branches of a company are considered in aggregate for the purposes of this rule, although it is possible to elect for individual branches to be streamed so that, for example, once all the losses previously incurred in a particular territory have been matched with profits from the same territory, any future profits from that territory will be exempt.

Excluded territories

The branch profits exemption is not available for a foreign branch of a "small" company if that branch is located in a country which does not have a full standard double tax treaty with the UK. A small company is defined in UK legislation in accordance with the EU commission guidelines as a company that: i) has fewer than 50 employees; and, ii) an annual turnover of less than, or equal to, €10 million and/or an annual balance sheet with assets of less than, or equal to, €10 million.

There may be other restrictions on the application of the rules where there are “diverted profits” as defined in the legislation.

How can Moore Kingston Smith help?

Trading overseas has a complex array of UK and overseas tax implications. We can help analyse how these issues apply to your business and advise whether making an election for the branch profits exemption is appropriate. Please do not hesitate to contact us should you wish to further discuss these issues.

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