

SCHEDULE A1: DETERMINATION OF PROFITS ATTRIBUTABLE TO PERMANENT ESTABLISHMENT: SUPPLEMENTARY PROVISIONS

SUMMARY

This schedule sets out provisions supplementing section 11AA ICTA 88 as regards the determination of profits attributable to permanent establishments. The provisions incorporate into UK tax law the principles contained within the OECD commentary on Article 7(2) and 7(3) of the Model Tax Convention on Income and on Capital (“the Commentary”) and Transfer Pricing and Multinational Enterprises Three Taxation Issues, The Taxation of Multinational Banking Enterprises, Chapter III, Banking and Financial Enterprises Operating Through Branches (“Three Taxation Issues”).

DETAILS OF THE SCHEDULE

1. **Paragraph 1(1)** specifies that the provisions of the Schedule supplement section 11AA ICTA 88 as regards the determination of the profits attributable to the UK permanent establishment of a non-UK resident company.
2. **Paragraph 1(2)** defines “the separate enterprise principle” as the principle in subsection 11AA(2) read with subsection 11AA(3).
3. **Paragraph 2** provides that in accordance with the separate enterprise principle, transactions between a permanent establishment and any other part of the non-resident company are treated as taking place on an arm’s length basis.
4. **Paragraph 3(1)** provides that section 11AA(4) ICTA 88 applies to expenses whether or not they have been incurred or reimbursed by the permanent establishment.
5. **Paragraph 3(2)** provides that the quantum of the expenses to be taken in to account under section 11AA(4) when arriving at the profits of the permanent establishment is the actual cost to the non-resident company.
6. **Paragraph 4(1)** provides that there is no deduction for royalties or similar payments made by a permanent establishment to any other part of the non-resident company in respect of the use of intangible assets held by the non-resident company.
7. **Paragraph 4(2)** provides that the restriction on deductions in paragraph 4(1) does not prevent the permanent establishment having a deduction for the costs of creating an intangible asset where these are paid to any other part of the non-resident company.
8. **Paragraph 4(3)** defines “intangible asset” as having the meaning it has for accounting purposes and includes intellectual property as defined in paragraph 2(2) of Schedule 29 to the Finance Act 2002.

9. **Paragraph 5(1)** provides that, subject to the exception in subparagraph 5(2), there is no deduction for payments of interest or other financing costs by a permanent establishment to any other part of the non-resident company.
10. **Paragraph 5(2)** provides that the restriction on deductions of interest or other financing costs in subparagraph 5(1) does not apply to interest or other financing costs that are payable in respect of borrowings by a permanent establishment in the ordinary course of a financial business carried on by it.
11. **Paragraph 5(3)** defines financial business to mean banking, deposit-taking, money-lending or debt factoring (or a business similar to any of those) dealing in commodity or financial futures.
12. **Paragraph 6(1)** specifies that paragraph 6 applies where a non-resident company provides its permanent establishment with goods or services.
13. **Paragraph 6(2)** provides that if the goods or services are of a kind that the non-resident company supplies to third parties at arm's length in the ordinary course of its business, then the separate enterprise principle applies to the transactions which are to be treated as taking place on an arm's length basis.
14. **Paragraph 6(3)** provides that if paragraph 6(2) does not apply then the cost of the services to the permanent establishment is the actual cost to the non-resident company.
15. **Paragraph 7(1)** specifies that the provisions of Part 3 of the Schedule apply to banks as defined by section 840A ICTA 88.
16. **Paragraph 7(2)** provides that nothing in Part 3 shall be read as preventing the application of similar principles to those set out in that Part, to a non-resident company that is not a bank..
17. **Paragraph 8(1)** provides that, in accordance with the separate enterprise principle, transfers of loans and other financial assets between a permanent establishment and any other part of the non-resident company are recognised only if they would have taken place between independent enterprises.
18. **Paragraph 8(2)** provides that even if the transfer were one that would have taken place between independent enterprises, it is not recognised where it cannot reasonably be considered that it is carried out for valid commercial reasons. The obtaining of a tax advantage is not a valid commercial reason for this purpose.
19. **Paragraph 9(1)** provides that in accordance with the separate enterprise principle, loans and other financial assets, and the profits arising from them, are attributed to a permanent establishment to the extent that they can reasonably be regarded as having been generated by the activities of the permanent establishment.
20. **Paragraph 9(2)** specifies that the provisions of subparagraphs 9(3) and 9(4) have effect as regards the factors to be taken into account in determining whether loans and other financial assets, and the profits arising from them can reasonably be

regarded as having been generated by the activities of the permanent establishment

21. **Paragraph 9(3)** specifies that particular account shall be taken of the extent to which the permanent establishment is responsible for obtaining the offer of new business, establishing the potential borrower's credit rating and the risk involved in providing credit, negotiating the terms of the loan with the borrower, and deciding whether, and if so on what conditions, to make or extend the loan.
22. **Paragraph 9(4)** specifies that account may also be taken of the extent to which the permanent establishment is responsible for concluding the loan agreement and disbursing the proceeds of the loan, and administering the loan (including handling and monitoring the service of it) and holding and controlling any security pledged.
23. **Paragraph 9(5)** defines "financial asset" to include any financial risk in relation to a loan or potential loan, that is capable of giving rise to fees or other receipts and for which the holding of capital is required (or would be required if the transaction were between parties at arm's length).
24. **Paragraph 10(1)** provides that paragraph 10 applies where a permanent establishment borrows funds for the purposes of another part of the non-resident company and in relation to that borrowing acts only as an agent or intermediary.
25. **Paragraph 10(2)** provides that in such a case the profits and capital attributable to the permanent establishment under section 11AA ICTA 88 shall be that appropriate in the case of an agent acting at arm's length, taking into account the risks and costs borne by the permanent establishment.