

DTR – Draft Guidance

Section 86 FA 2005 – Case V Income

Outline

DTR is given when income taxable in the UK is also subject to foreign tax. The purpose of Clause 86 is to limit DTR to no more than the UK tax due on the same income, so that UK tax on unrelated income is not reduced.

To do this it provides rules to determine the amount of UK income that is relevant to the foreign tax payment. In particular, where expenses are taken into account in calculating the amount of taxable income, the clause requires a proportion of those expenses must be attributed to the foreign income.

Where there are no such expenses – as in the case of foreign dividend income received otherwise than in the course of a trade – there is no difficulty in identifying the amount of income because it is simply the whole of the foreign dividend. There are no expenses to consider.

Detail

Section 798A(2) amends meaning of “relevant income” in section 797(1), to make clear that it refers only to so much of the taxpayer’s income that relates to the foreign tax payment. This prevents the foreign tax being set against unrelated income.

Where expenses are allowed in the calculation of the amount liable for tax, section 798A(3) requires those expenses to be taken into account in calculating the relevant income.

If income is taxed without deduction of expenses (such income is often referred to as “pure income profit”), then there are no expenses to set against the income, so section 798A(3) has no effect.

Section 797(3) makes it clear that management expenses and other expenses that can be set against more than one source of income may be allocated against sources according to the taxpayer’s choice. Section 798A does not override section 797(3) and so there is no requirement to set such expenses against Case V income.

Therefore Case V income that represents pure income profit, including foreign dividend income that is not received by way of trade, is not affected by the new section 798A.

Income from a foreign trade is also taxable under Case V, and trade expenses should be taken into account in determining the DTR available in such cases. It is also possible that trade income might be diverted to another company where it falls to be taxed under Case V. Such income would not represent “pure income profit” and so expenses would be allocated under section 798A(3).