

Corporation Tax: Bill 6
Permanent establishments and UK representatives
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Permanent establishments and UK representatives

Overview

1. Chapter 1 rewrites sections 148 and 152 of, and Schedule 26 to, FA 2003 which determine what constitutes a permanent establishment of a company in a territory.
2. Chapter 2 rewrites section 150 of FA 2003 which deals with the assessment, collection and recovery of corporation tax from the UK representative of a non-UK resident company carrying on a trade through a permanent establishment in the United Kingdom.
3. These Chapters are likely to be included in a separate Part of Bill 6, provisionally entitled “Non-UK resident companies”, together with other material including that rewriting Schedule 28 to FA 2000 (Recovery of tax payable by non-resident company).
4. The commentary uses a number of abbreviations. They are listed below.

Bill 5	the draft Corporation Tax Bill published on 22 February 2008 (and references to numbered Parts, Chapters and clauses of, and Schedules to and paragraphs of Schedules to, Bill 5 are to the Parts, Chapters, clauses, Schedules and paragraphs so numbered in that draft)
CRCA	the Commissioners for Revenue and Customs Act 2005
FA 2003	Finance Act 2003 (and similarly for other Finance Acts)
FB 2008	Finance Bill 2008 (and references to numbered Parts, Chapters, and clauses of, and Schedules to and paragraphs of Schedules to, FB 2008 are to the Parts, Chapters, clauses, Schedules and paragraphs so numbered in FB 2008 as published on 27 March 2008)
ICTA	the Income and Corporation Taxes Act 1988
ITA	the Income Tax Act 2007
TMA	the Taxes Management Act 1970

Chapter 1: Permanent establishments

Overview

5. This Chapter determines what constitutes a permanent establishment in a territory of a company which is not resident in that territory. The determination is in

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line with various internationally recognised characteristics commonly used in the United Kingdom's double tax agreements.

6. If a non-UK resident company trades in the United Kingdom through a permanent establishment here, it is chargeable to corporation tax on its "chargeable profits". Section 11(2) of ICTA defines "chargeable profits" as the trading income arising directly or indirectly through or from the permanent establishment and the other income and chargeable gains referred to in section 11(2A) of ICTA attributable to the permanent establishment in accordance with section 11AA of ICTA. Sections 11(2) and (2A) and 11AA of ICTA are rewritten in Chapter 4 of Part 2 of Bill 5.

7. If a non-UK resident company is chargeable to tax in respect of any other income from a United Kingdom source, it is charged to income tax and its liability is limited in accordance with Chapter 1 of Part 14 of ITA. The extent to which the non-UK resident company is chargeable to tax in respect of such income may be limited by the terms of any applicable double tax agreement.

Clause 1: Permanent establishments of companies

8. This clause sets out the basic tests for determining whether a company resident in a territory has a permanent establishment in another territory. It is based on section 148(1) and (2) of FA 2003.

9. This clause is not limited to permanent establishments in the United Kingdom of non-UK resident companies but also serves to determine whether a UK resident company has a permanent establishment in another territory. Under double taxation agreements adopting the OECD model convention, sole taxing rights in relation to the profits of a trade carried on by a company resident in the territory of one of the contracting states through a permanent establishment in the territory of the other contracting state are ceded to the fiscal authorities of the other contracting state.

10. *Subsection (3)* refers to the following three clauses which set out circumstances in which there is no permanent establishment, notwithstanding that the conditions in *subsection (1)* are met.

Clause 2: Agent of independent status

11. This clause prevents a company which is not resident in a territory from being treated as having a permanent establishment in that territory merely because it carries on business in that territory through an agent of independent status there. It is based on sections 148(3) and 152 of, and paragraph 1(1) and (2) of Schedule 26 to, FA 2003.

12. *Subsection (2)* introduces clauses 5 to 13 which contain special provisions in relation to non-UK resident companies concerning transactions carried out through a broker in the United Kingdom, investment transactions carried out through an investment manager in the United Kingdom and Lloyd's underwriting business.

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Clause 3: Preparatory or auxiliary activities

13. This clause treats a company which is not resident in a territory as not having a permanent establishment in that territory if the activities carried on in that territory are only of a preparatory or auxiliary character. It is based on section 148(4) and (5) of FA 2003.

14. *Subsection (3)* sets out a non-exhaustive list of activities of a preparatory or auxiliary character.

Clause 4: Alternative finance arrangements

15. This clause provides that a non-UK resident company which is party to alternative finance arrangements is not treated as having a permanent establishment in the United Kingdom merely because of anything done by the counter-party to the arrangements or any other person acting for the non-UK resident company in relation to the arrangements. It is based on section 148(5A) and (5B) of FA 2003.

16. This clause cross-refers to provisions of Chapter 5 of Part 2 of FA 2005 which are to be rewritten for corporation tax purposes in Chapter 6 of Part 7 of Bill 5. As explained in the commentary on clause 500 of Bill 5 in the explanatory notes to Bill 5, Bill 5 proposes to dispense with the term “profit share return”. This will result in section 148 of FA 2003 being consequentially amended by omitting subsection (5B) and including in subsection (5A) references to section 49A of FA 2005 and to clause 500 of Bill 5 (see paragraph 403 of Schedule 1 to Bill 5).

17. The final version of this clause will reflect the consequential amendments made to section 148(5A) and (5B) of FA 2003 when Bill 5 is enacted. But for the time being this clause does not anticipate the proposed amendments.

Clause 5: The independent broker conditions

18. This clause sets out the conditions to be met if a broker in the United Kingdom is to be treated as an agent of independent status for the purposes of clause 2(1), and therefore not a permanent establishment, in relation to a transaction carried out on behalf of a non-UK resident company by the broker. It is based on paragraphs 1(1) and 2 of Schedule 26 to FA 2003.

19. In *subsection (6)* the words “(apart from this subsection)” have been added for the reasons given in *Change 624* in Annex 1.

<p>Q1. We welcome comments on the addition of the words “(apart from this subsection)” in clause 5(6).</p>

Clause 6: The independent investment manager conditions

20. This clause sets out the conditions to be met if an investment manager in the United Kingdom is to be treated as an agent of independent status for the purposes of clause 2(1), and therefore not a permanent establishment, in relation to an investment

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transaction carried out on behalf of a non-UK resident company by the investment manager. It is based on paragraphs 1(1), 3 and 7(2) of Schedule 26 to FA 2003.

21. As announced on 12 March 2008 (see BN28), paragraph 9(2) of Schedule 16 to FB 2008 omits paragraph 3(2)(f) of Schedule 26 to FA 2003. The condition in paragraph 3(2)(f) of Schedule 26 to FA 2003 is in the meantime retained in square brackets as *subsection (8)*.

Clause 7: Investment managers: the 20% rule

22. This clause sets out the “20% rule” for investment managers. It is based on paragraph 4(1) of Schedule 26 to FA 2003.

23. The 20% rule has two requirements. The first requirement is that the investment manager and connected persons must intend that any interest that they may have in the non-UK resident’s “relevant disregarded income” will not exceed 20% of that income. The second requirement applies if that intention is not fulfilled. The 20% rule will continue to be met if the only reason why it is not fulfilled is because of matters outside the control of the investment manager or connected persons despite their having taken reasonable steps to mitigate the effect of those matters.

24. In *subsection (2)* the term “relevant disregarded income” has been substituted for the term “relevant excluded income” which appears in paragraph 4(1) of Schedule 26 to FA 2003. The same substitution was made in section 819(2) of ITA which is also based on paragraph 4(1) of Schedule 26 to FA 2003. See the commentary on clause 8.

Clause 8: Section 7: interpretation

25. This clause defines three terms used in clause 7. It is based on paragraph 4(2) to (4) of Schedule 26 to FA 2003.

26. *Subsection (2)* makes explicit that the accounting periods referred to in paragraph 4(2) of Schedule 26 to FA 2003 are those of the non-UK resident company.

27. *Subsection (3)* adopts the term “relevant disregarded income” in preference to the term “relevant excluded income” in paragraph 4(3) of Schedule 26 to FA 2003. Section 821 of ITA, which is also based on paragraph 4(3) of Schedule 26 to FA 2003, similarly adopts the term “relevant disregarded income”.

28. In *subsection (3)*, a reference to “the total of the non-UK resident company’s income” has been substituted for the reference in paragraph 4(3) of Schedule 26 to FA 2003 to “the aggregate of such of the chargeable profits of the company”. See *Change 626* in Annex 1.

Q2. We welcome comments on the use of “the total of the non-UK resident company’s income” in clause 8(3).

Clause 9: Treatment of transactions if requirements of 20% rule are not met

29. This clause provides that, in relation to a transaction in respect of which the independent investment manager conditions are met except for the requirements of the 20% rule, the investment manager exemption will apply but only to a limited extent. It is based on paragraph 4(5) of Schedule 26 to FA 2003.

30. Paragraph 4(5) of Schedule 26 to FA 2003 provides that the exemption will apply only in relation to that part of the non-UK resident company’s income from the transaction to which the investment manager and persons connected with the investment manager are not beneficially entitled.

31. As a consequence of the omission of paragraph 3(2)(f) of Schedule 26 to FA 2003 by paragraph 9(2) of Schedule 16 to FB 2008, paragraph 9(4) inserts a new paragraph 5A in Schedule 26 to FA 2003. The new paragraph 5A provides that, in either of the cases set out in sub-paragraphs (3) and (4), the profits derived from any investment transaction carried out by the investment manager on behalf of the non-resident company are to be disregarded when attributing profits to a permanent establishment represented by the investment manager.

32. The new paragraph 5A(4) and (5) of Schedule 26 to FA 2003 reproduce the effect of paragraph 4(5) of that Schedule which is omitted by paragraph 9(3) of Schedule 16 to FB 2008. See the explanatory notes to clause 35 of, and Schedule 16 to, FB 2008.

33. If the amendments to Schedule 26 to FA 2003 contained in paragraph 9 of Schedule 16 to FB 2008 are enacted, clause 9 will be omitted and the new paragraph 5A of Schedule 26 to FA 2003 will instead be rewritten. Clause 9 is in the meantime retained in square brackets.

Clause 10: Application of 20% rule to collective investment schemes

34. This clause modifies the 20% rule where the non-UK resident company is a participant in a collective investment scheme. It is based on paragraph 5 of Schedule 26 to FA 2003.

35. This clause applies at the level of the scheme itself, treating the scheme as if it were a non-UK resident company, see *subsection (3)*.

36. A minor drafting change has been made in subsection (3) by substituting reference to a non-UK resident company for the reference in paragraph 5(2) of Schedule 26 to FA 2003 to a company resident outside the United Kingdom. This has been done to clarify the assumption and in this context does not change the effect of the law. The same minor drafting change was made in section 824(3) of ITA.

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37. *Subsection (4)* applies to a scheme which, if it was assumed to be a non-UK resident company, would *not* be regarded as carrying on a trade in the United Kingdom. The 20% rule is treated as satisfied in relation to such a scheme.

38. *Subsection (5)* applies to a scheme which, if it was assumed to be a non-UK resident company, would be regarded as carrying on a trade in the United Kingdom. The 20% rule applies to such a scheme with the modifications in *subsection (6)*.

Clause 11: Meaning of “investment manager” and “investment transaction”

39. This clause defines the terms “investment manager” and “investment transaction” which underlie the independent investment manager conditions. It is based on paragraph 3(1), (3) and (4) of Schedule 26 to FA 2003.

40. Regulations (SI 2003/2173 and SI 2007/964) have been made under paragraph 3(3)(c) of Schedule 26 to FA 2003, designating as investment transactions:

- swap contracts settled in cash or foreign currency (other than contracts relating to land, insurance or capital redemption business) and
- transactions in Community tradeable emissions allowances and in transferable units issued pursuant to the Kyoto Protocol.

41. As announced on 12 March 2008 (see BN28) paragraph 3(1) of Schedule 16 to FB 2008 amends the meaning of “investment transaction”, so that in accordance with paragraph 11(4) and (5) of that Schedule investment transactions will be those transactions that are for the time being specified by order made by the Commissioners for Her Majesty’s Revenue and Customs. Transactions so specified will include the transactions currently specified in paragraph 3(3)(a) and (b) or designated under paragraph 3(3)(c) of Schedule 26 to FA 2003.

Clause 12: Lloyd’s agents

42. This clause applies if a person in the United Kingdom acts as the members’ agent of a non-UK resident company which is trading as a corporate member of Lloyd’s or if the person acts as the managing agent of a Lloyd’s syndicate of which the non-UK resident company is a member. It is based on paragraph 6 of Schedule 26 to FA 2003.

43. This clause provides that the members’ agent or managing agent is to be treated as an agent of independent status for the purposes of clause 2(1), and therefore not a permanent establishment, in relation to a transaction carried out on behalf of the non-UK resident company in the course of the non-UK resident company’s underwriting business at Lloyd’s.

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Clause 13: Supplementary provision

44. This clause explains when a person is to be regarded as carrying out a transaction on behalf of another and makes provision for a person part only of whose business is as a broker or investment manager. It is based on paragraph 7(1) and (4) of Schedule 26 to FA 2003.

45. *Subsection (3)* has been retained in square brackets as a marker. The definition of connected persons in section 839 of ICTA is expected to be rewritten in Bill 6 and applied generally for the purposes of Bill 6. In that event, subsection (3) will be omitted.

Chapter 2: Collection etc. of tax from UK representatives of non-UK resident companies

Overview

46. This Chapter sets out the obligations and liabilities of a UK representative of a non-UK resident company carrying on a trade through a permanent establishment in the United Kingdom in relation to the assessment, collection and recovery of corporation tax on the chargeable profits of the non-UK resident company attributable to the permanent establishment. As to “chargeable profits” see section 11(2) of ICTA (rewritten in clause 19 of Bill 5).

47. Section 150 of FA 2003 is an administration provision. This Chapter could, therefore, be rewritten for insertion in TMA. But we consider that it is preferable to keep it with Chapter 1 in Bill 6, as in the source legislation.

Q3. We welcome comments on the proposal to include Chapter 2 in Bill 6.

Clause 14: Introduction

48. This clause introduces the Chapter and sets out the rules for determining the extent to which and the period for which a permanent establishment is a UK representative. It is based on section 150(1) and (2) of FA 2003.

49. A permanent establishment in the United Kingdom through which a non-UK resident company carries on a trade is the UK representative of the non-UK resident company in relation to the chargeable profits attributable to the permanent establishment. See *Rule 1* in *subsection (3)*.

50. If a permanent establishment in the United Kingdom of a non-UK resident company ceases to be its permanent establishment, it nevertheless continues thereafter to be the UK representative of the non-UK resident company in relation to the chargeable profits attributable to the permanent establishment. See *Rule 2* in *subsection (3)*.

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51. In *subsection (4)*, the reference to section 11(2A) of ICTA in the source legislation will be consequentially amended by Bill 5 to refer to the rewritten provision (clause 19 of Bill 5).

Clause 15: Obligations and liabilities in relation to corporation tax

52. This clause treats the obligations and liabilities of the non-UK resident company in respect of the chargeable profits of the trade carried on through a permanent establishment in the United Kingdom as also being the obligations and liabilities of the UK representative. It is based on section 150(1) and (3) of FA 2003.

Clause 16: Exceptions

53. This clause sets out circumstances in which:

- certain obligations or liabilities of a non-UK resident company attach to its UK representative (*subsections (1) and (2)*),
- a non-UK resident company is bound by the mistakes of its UK representative (*subsection (3)*) and
- a UK representative may be proceeded against for a criminal offence (*subsection (4)*).

It is based on section 150(4) to (6) of FA 2003.

Clause 17: Interpretation of Chapter

54. This clause defines terms used in the Chapter. It is based on section 150(7) of FA 2003.

55. In the definition of “information”, the words “to the Commissioners for Her Majesty’s Revenue and Customs or to any officer of Revenue and Customs” have been substituted for the words “to the Board or any officer of the Board” in the source legislation. This gives effect to section 50(1) and (2) of CRCA which require references to the terms in the source legislation to be taken as references to the substituted terms.

56. The definition of “trade” by cross-reference to section 6(4)(b) of ICTA has been retained for the time being. Bill 5 proposes that section 150 of FA 2003 be consequentially amended to substitute a stand alone definition of “carrying on a trade” in the same terms as that in clause 33(b) of Bill 5 (see the commentary on that clause in the explanatory notes to Bill 5). The final version of this clause will reflect any consequential amendments made to section 150 of FA 2003 when Bill 5 is enacted.

ANNEX 1: CHANGES IN THE LAW

Change 624: Non-UK resident companies: transactions through brokers: Clause 5

This change removes a difference between:

- the wording of one of the conditions which determines whether or not, in relation to transactions carried out by a non-UK resident company (otherwise than as a trustee) through a broker in the United Kingdom, the broker is the permanent establishment of the non-UK resident company and
- the wording of the parallel condition which determines whether, in relation to transactions carried out by any other non-UK resident through such a broker, the broker is the UK representative of the non-UK resident.

Prior to the enactment of section 148 of, and Schedule 26 to, FA 2003, sections 126 and 127 of FA 1995 applied to determine who was the UK representative of a non-UK resident (including a non-UK resident company) in respect of income or chargeable gains arising through a branch or agency in the United Kingdom. Section 127 of FA 1995 provides that certain branches or agents are not UK representatives in relation to income or chargeable gains arising from a transaction carried out through them, including, in particular, brokers who meet certain conditions in relation to the transaction.

Following the enactment of section 148 of, and Schedule 26 to, FA 2003, the provisions of FA 1995 only apply in relation to non-UK residents who are not companies and to non-UK resident companies in the capacity of trustees. The FA 2003 provisions determine whether or not a person is the permanent establishment of a company in another territory and, in the case of a permanent establishment in the United Kingdom, provide for the permanent establishment to be the UK representative of the non-UK resident company in relation to income or chargeable gains arising through the permanent establishment.

Under Schedule 23 to FA 1995, a branch or agency which is a UK representative is responsible for assessment and payment of the income tax and capital gains tax chargeable on the income and chargeable gains of the non-UK resident arising through the branch or agency. Under section 150 of FA 2003, a permanent establishment in the United Kingdom is responsible for assessment and payment of corporation tax on income or chargeable gains attributable to the permanent establishment.

Section 148(3) of FA 2003 provides that a company is not regarded as having a permanent establishment in a territory by reason of its carrying on business there through an agent of independent status acting in the ordinary course of the agent's business. Schedule 26 to FA 2003 supplements that provision by, among other things,

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setting out the conditions under which transactions carried out through a broker in the United Kingdom will be treated as carried out through an agent of independent status.

Paragraph 2 of Schedule 26 to FA 2003 provides for conditions that apply in determining whether a broker is a permanent establishment in respect of transactions carried out by a non-UK resident company through the broker in the United Kingdom. Under the FA 2003 legislation it was intended that these conditions would be the same as those that apply when determining, under section 127(2) of FA 1995, whether a broker is the UK representative of any other non-UK resident in relation to transactions carried out by that non-UK resident through the broker.

Section 127(2)(d) of FA 1995 contains the words “(apart from this paragraph)”. But those words were not included in the parallel condition in paragraph 2(2)(d) of Schedule 26 to FA 2003. No change was intended and that provision is in practice operated in the same way as section 127(2)(d) of FA 1995.

The effect of the additional words in section 127(2)(d) of FA 1995 is that the question whether the broker is to be regarded as the UK representative of the non-UK resident in relation to the income (or other amounts) in question is to be determined without reference to the condition in that paragraph. They are considered necessary to avoid the impasse that would otherwise arise in operating the condition in accordance with the following analysis:

- A transaction will fall within section 127(2)(d) of FA 1995 only if there is no income or other amount chargeable to tax for the same tax year in relation to which the broker is the non-UK resident’s UK representative.
- If there is any other income or amounts deriving from another transaction carried out by the broker for the non-UK resident, section 127(1)(b) and (2) will apply to determine whether the broker is the non-UK resident’s UK representative in relation to it.
- For the broker not to be the non-UK resident’s UK representative, the second transaction will have to fall within section 127(2).
- But absent the words “(apart from this paragraph)”, in applying the condition in section 127(2)(d) to the second transaction, the question whether the condition is met depends on whether it is met in relation to the first transaction.

This change removes the potential for such an impasse in the provisions for determining whether a broker in the United Kingdom is the permanent establishment of a non-UK resident company in relation to transactions carried out by the non-UK resident company through the broker. It does so by adding words equivalent to “(apart from this paragraph)” in clause 5(6).

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This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 626: Meaning of permanent establishment: substitution of reference to income for reference to chargeable profits in paragraph 4(3) of Schedule 26 to FA 2003: clause 8

This change substitutes a reference to a non-UK resident company's income in clause 8(3) for the reference to its chargeable profits in paragraph 4(3) of Schedule 26 to FA 2003.

This change is identical to the change made in rewriting paragraph 4(3) of Schedule 26 to FA 2003 in section 821(3) of ITA 2007 in relation to the limit on liability to income tax of non-UK resident companies under section 815 of that Act. See Change 121 in Annex 1 to the Explanatory Notes to ITA 2007.

Paragraph 3 of Schedule 26 to FA 2003 sets out conditions relating to investment transactions carried out by a non-UK resident company (other than a company in the capacity of a trustee) through an investment manager in the United Kingdom. If the conditions in paragraph 3(2) are met, the investment manager will not be a permanent establishment of the non-UK resident company in relation to the investment transactions. The non-UK resident company's profit on those transactions will be chargeable not to corporation tax but to income tax and then only to the extent provided by section 815 of ITA 2007.

Paragraph 4 of Schedule 26 to FA 2003 sets out the requirements of "the 20% rule" referred to in paragraph 3(2)(d) of that Schedule. This rule relates to the percentage of "relevant excluded income" in which the investment manager and connected persons may have a beneficial interest. It is equivalent to section 127(5) of FA 1995 which prior to FA 2003 applied to all non-UK residents but which since the enactment of section 148 of, and Schedule 26 to, FA 2003 only applies where the non-UK resident is not a company (other than a company in the capacity of a trustee).

The basis on which the legislation in FA 2003 was prepared was that it was not to affect the law under FA 1995, except so far as required to adopt the concept of permanent establishment in place of branch or agency in relation to non-UK resident companies (other than companies in the capacity of trustees).

It is clear from the reference in the definition of "relevant excluded income" in section 127(5) of FA 1995 to "such of the profits and gains of the non-resident...as...for the purposes of section 128 below would fall (apart from the requirements of subsection (4) above) to be treated as excluded income" that the defined term in that Act is limited to income and does not include gains. This has been reflected in section 821(2) of ITA 2007.

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The reference to “the aggregate of such of the chargeable profits of the company” in paragraph 4(3) of Schedule 26 to FA 2003 is, therefore, in practice read as referring to income only.

Accordingly, clause 8(3) refers to “the total of the non-UK resident company’s income for the accounting periods” which derives from the relevant investment transactions.

This change is in taxpayers’ favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.