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Dawn Primarolo

(Bristol South – Lab)

Amendment 1

Schedule 1, page 156, line 22 [Vol I], after ‘the’ insert ‘relevant proportion (see sub-paragraph (5)) of the’.

Amendment 2

Schedule 1, page 156, line 32 [Vol I], at end insert ‘and “the relevant proportion” means the proportion that the appropriate part of the EEA amount bears to the EEA amount’.

SUMMARY

1. Clause 27 and Schedule 1 provide for an extension to the rules that give relief for losses and other amounts within groups of companies (group relief). Schedule 1 sets out the conditions to be met for foreign losses to be relievable as group relief in the UK. It also sets out how the amount relievable is to be computed and the compliance obligations of the UK claimant company. These rules will apply from 1 April 2006.
2. The two proposed amendments relate to the comparison of the foreign loss with the amount recalculated under UK rules, and the amount of group relief that is available as a result of this recalculation and comparison.
3. Schedule 1 as currently drafted could result in some cases in the UK giving relief for foreign losses that are relievable elsewhere. The proposed amendments will prevent this.

DETAILS

4. A new Schedule 18A is inserted in the Income and Corporation Taxes Act 1988 by paragraph 7 of Schedule 1. Paragraph 11(1) of Schedule 18A provides that the EEA amount (defined by Schedule

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18A paragraph 10(1)) must be recalculated in accordance with the applicable UK tax rules (as defined in paragraph 16) subject to the relevant assumptions (as defined in paragraph 11(5)).

5. Paragraph 11(2) provides that the amount of the EEA amount available for group relief surrender by the EEA company is so much of the appropriate part of it that does not exceed the amount given by that recalculation.
6. The appropriate part of the EEA amount is that part of the EEA amount which meets the conditions in section 403F(2).
7. The intention of paragraph 11(2) is to compare the loss or other amount (the EEA amount) of the non resident company with that amount as recalculated under UK rules. Where only a proportion of the EEA amount is available for group relief – for example, because some part of it is relievable elsewhere – the comparison to be made should be with that same proportion of the UK recalculated amount.
8. Paragraph 11(2) does not currently provide for the comparison to be made on this basis. The first amendment ensures that this technical defect is corrected, by providing that the foreign loss is compared with ‘the relevant proportion’ of the UK recomputed amount.
9. The second amendment provides the necessary definition of ‘the relevant proportion’. It provides that this proportion is the proportion that the appropriate part of the EEA amount bears to the EEA amount.

BACKGROUND NOTE

10. Under section 402 Income and Corporation Taxes Act 1988, a group company can claim to set the losses of another group company against its profits, thereby reducing the amount of corporation tax it pays. However, under the existing rules, this applies only if both the claimant company and the surrendering

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company are UK resident or carrying on a trade in the UK through a permanent establishment.

11. On 13 December 2005 the Court of Justice of the European Communities (CJEC) handed down its decision in the case of Marks & Spencer plc v. Halsey. This case concerned the UK's group loss relief rules for companies.
12. In summary, the Court ruled that the UK's group loss relief rules are in principle compatible with European law, but go too far in denying loss relief to a parent company for the losses of a foreign subsidiary where the parent company has demonstrated that the non-resident subsidiary has exhausted all possibilities of relief in its state of residence.
13. Clause 27 and Schedule 1 provide for an extension to the group loss relief rules. The new relief applies only where a UK parent company has a foreign subsidiary (including an indirectly held subsidiary) which has incurred a foreign tax loss that is unrelievable in the home state (or elsewhere), and where that subsidiary is either resident in the EEA or has incurred the relevant losses in a permanent establishment in the EEA.
14. The foreign losses are 'relievable in the UK' only where all possibilities of relief have been exhausted and future relief is unavailable in the country where they were incurred or in any other country. Where there is a foreign company in the ownership chain between the surrendering company and a UK parent, precedence rules apply to determine whether relief is available in the UK.
15. In order to obtain relief against UK profits the foreign tax loss will need to be recomputed under UK tax principles. This means that relief is only available for losses or other amounts that may be surrendered under the existing UK rules. In addition, when calculating the amount of the relief, regard is had to the overall amount of the unrelieved foreign loss. Relief is not given for an amount that does not represent an unrelieved foreign tax loss.