



Association for Financial  
Markets in Europe



The voice of banking  
& financial services

## **Joint AFME/BBA submission on the 'Foreign Branch Taxation' discussion document**

The Association for Financial Markets in Europe (AFME) and the British Bankers' Association (BBA) welcome the publication of the discussion document "Foreign Branch Taxation" in July 2010 and the opportunity to offer comment on the proposals and questions raised.

We would, of course, be happy to clarify any points raised in these comments and discuss any issues related to our understanding of HM Treasury (HMT) and HM Revenue and Customs' (HMRC) intentions. We look forward to continuing this dialogue and to further meetings with officials at the appropriate stage.

AFME and the BBA re-affirm their commitment to transparency and openness in dealings between their members and HM Government and the observations and comments that follow are provided in that light.

### **General**

The discussion document notes the intention to include legislation in Finance Bill 2011, which is welcome. We believe that reform which seeks to address the discrimination in taxation between the foreign subsidiaries owned by UK companies and the foreign branches of UK companies is needed to ensure a level playing field and is rightly being expedited.

The decoupling of the reform of branches from the work on the Controlled Foreign Companies (CFC) legislation is helpful; the conclusion of the CFC work is needed, but the decoupling allows the reform of the taxation of branches to be completed more speedily. We welcome the commitment of HMT and HMRC to ensure that the views of the sector will be taken into account in preparing the formal consultation on CFCs.

A key aim of the reform of the taxation of foreign profits is to make the UK more attractive internationally, a move which we collectively fully endorse. The reform of the taxation of foreign profits and the imposition of the bank levy are following different approaches. We do not seek to comment on the imposition of the bank levy in this letter, but note that the imposition of a levy on the worldwide liabilities of foreign branches of UK banks and UK owned foreign subsidiaries, at a time when the UK is moving to a territorial basis of taxation for the profits of those entities, sends a mixed message about the UK's tax policy and is unlikely to achieve a coherent result.

### **Scope of exemption**

We would note that those entities with foreign branch operations already have an obligation to seek to establish the profitability of their branches for the purposes of determining double tax relief by means of credit for foreign taxes paid against UK tax. We would urge that the scope of the exemption be set by reference to existing provisions. This has the merit of simplicity, in allowing both HMRC and taxpayers to operate by reference to existing procedures and precedent.

## **Quantification of branch profits**

We consider that the correct approach is as set out in the footnote on page 7 of the discussion document i.e. that the exempt branch income should be the same income as currently determines the limit of credit relief, whether the relief is currently given by reason of a treaty or unilaterally - please also see **Treaty Based Branches** below. This again has the merit of simplicity, in that it would enable present tested and agreed compliance processes to be maintained.

## **Attribution of capital**

Capital should be attributed to non UK branches in the same manner in which capital is attributed to UK branches of non UK companies.

We would note that the existing rules may in some cases conflict with double tax treaties and this has to be addressed in attributing capital to branches.

## **Chargeable gains**

While we believe the aim should be for capital gains of the branch to be treated in a manner consistent with those of a subsidiary, we are concerned that the issues raised in the paper will result in significant complexity in translation into legislation and therefore in operation.

We reluctantly conclude therefore that capital assets should be excluded from the reform, at least initially, with the proviso that there be some mechanism for addressing intra group transfers, especially those that are driven by regulatory requirements or regulatory reforms. Such a mechanism will be needed in order to ensure that there is a "level playing field" between subsidiaries and branches.

## **Artificial diversion of profits**

We accept that a level playing field with foreign subsidiaries also implies some similar protection in the case of branches but without knowing how the CFC reform will be resolved it is difficult to present a view on how to afford protection from the artificial diversion of profits in the context of branches. We have set out below the issues which we have identified in our discussion on potential approaches for branches:-

- a) For trading branches, we question whether CFC type protection is needed, particularly if capital gains are excluded from the exemption. The attribution of profits will be linked to the activities and functions performed in the branch and a CFC type approach would appear to simply add complexity.
- b) In the context of such trading branches, the attribution of capital would appear to be the most significant matter which arguably gives rise to such risk and this has been separately addressed.
- c) We can see practical difficulties in seeking to impose CFC type rules on a branch. We have previously discussed our concerns over the use of quantitative measures in determining the application of a CFC regime e.g. relative number of employees, ownership of assets, location of customers. Our discussions and concerns have been in the context of subsidiaries, but applying similarly measures in the context of branches would be meaningless and require such a degree of deeming provisions as to make careful targeting of their impact practically impossible.

## **Treaty based branches**

While the UK has a wide treaty network, we are concerned that limiting the approach to jurisdictions with which the UK has a treaty would be disadvantageous. The UK has built a strong financial sector, internationally recognised, and has benefited from the development of non UK financial markets. To limit the application of the rules to those jurisdictions with treaties would limit the benefit of the reforms, discouraging entry into newly emerging markets with which there is no treaty. We consider therefore that, as with foreign subsidiaries, there should be no restriction on the territories to which the exemption should apply.

## **Branch losses**

We recognise the efforts that have been made to reconcile the differing demands of sectors and in particular the approach on losses, which seems a significant step in allowing the branch exemption proposal to proceed.

We would support the option set out in 4.9 of the discussion document with exemption being coupled with current UK relief for foreign losses, subject to a clawback of this relief as and when the loss is utilised overseas. The effect of this would be to replicate the reversal of benefit that occurs under the existing credit regime.

This would require some form of tracking system to ensure that the reversal occurs as the losses are utilised but this would, we consider, require some deeming rules to ensure that the compliance burdens aren't excessive.

Thus if there was a UK profit of 100, a foreign branch A profit of 100 and a foreign branch B loss of 100 we would consider that the non UK results should be aggregated first to determine whether there is an overall loss to be used against a UK profit. In this example there is not, so there would be no requirement to track the future use of the loss in branch B.

If in the above example branch A had also made a loss of 100 then there would be a 200 aggregate loss to set against the UK profit of 100. It would thus be necessary to determine which overseas loss this is so that its future utilisation could be determined. We would suggest that a sensible approach would be to pro-rate the 100 between the foreign branches with losses, in this case that would mean 50 for each of branches A and B.

## **Transitional rules**

The exemption regime for foreign dividends was introduced without similar transitional rules. We urge that this approach is followed for branches.

While the application of a loss relief clawback model as above would remove the need for an elective regime, significant difficulties remain in seeking to identify losses, which might be subject to transitional provisions. For instance, even if the profit and losses of branches can be established historically, the set off of those losses by year within the trade, within the entity and within the group need to be addressed, as noted above. At a minimum, if there are to be transitional provisions these should be restricted to losses arising within the last three years in order to avoid disproportionate compliance burdens.

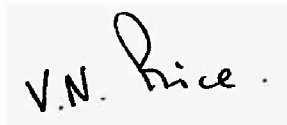
Similarly, for instance, an allocation of capital allowances, waivers and pools would be required. The ability to produce a "fair and reasonable" estimation is undermined by the extent of the variables and we would urge a similar approach to that taken for dividends.

If transitional rules are to be introduced and the complexities above arise, we would urge that taxpayers be given an elective choice to adopt the new regime or to stay within the existing regime.

### **Manufactured Overseas Dividends**

From our discussions, we note that consideration is being given to the impact of the proposed reform on the Manufactured Overseas Dividend regime. We would be pleased to meet with you on this issue with you when you are ready to progress discussions.

We would be very pleased to discuss the substance of this consultation response with you further and look forward to seeing the results of the consultation.



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