

Reform of the foreign permanent establishment exemption

Comments from Saffery LLP

1. Executive summary

1.1 We welcome the opportunity to comment on the draft legislation reforming the taxation of foreign permanent establishments.

1.2 In summary, our key points are as follows:

- Restricting relief for historic foreign permanent establishment losses may adversely affect groups that have already invested overseas.
- A longer transitional period would help existing groups adapt to the new regime.
- Additional clarification is needed on the treatment of excess foreign tax credits.
- The reforms may increase compliance obligations, particularly for small and medium-sized enterprises (SMEs).
- The reforms provide an opportunity to simplify the regime by extending the exemption to small companies with permanent establishments in territories that are not full treaty territories.
- Making the exemption mandatory will restrict access to research and development (R&D) relief for activities undertaken through overseas permanent establishments.

1.3 Section 2 below sets out our comments on the draft legislation.

1.4 We would be happy to discuss the points raised here in further detail. If you have any questions, or would like any further information, please contact: Sean McGinness, National Tax Partner, on +44 (0)131 221 3217 or email sean.mcginness@saffery.com or Ami Jack, Partner, National Tax, on +44 (0)330 094 3079 or email ami.jack@saffery.com.

2. Comments on the draft legislation

2.1 Transitional treatment of losses

2.1.1 Many groups will already have made commercial decisions and committed capital on the basis that losses arising in foreign permanent establishments would be available for UK tax purposes.

2.1.2 These losses often represent genuine economic costs incurred in establishing or expanding overseas operations. In some cases, those costs may never be recovered if the permanent establishment does not become profitable.

2.1.3 The availability of relief for initial losses can be an important consideration when groups evaluate overseas expansion. Restricting relief for those losses may discourage some groups from expanding outside the UK, and will adversely affect some groups that have already done so.

2.2 Foreign tax credits

2.2.1 We would welcome clarification of the treatment of excess foreign tax credits where foreign permanent establishment profits become exempt from UK corporation tax.

2.2.2 While this may not be a significant issue in practice where permanent establishment profits are exempt in any event, additional clarification would be helpful.

2.3 Transitional period

- 2.3.1 A longer transitional period would be helpful in relation to the proposed loss restrictions.
- 2.3.2 A transitional period of five years would provide additional time for existing groups to adapt to the new regime.
- 2.3.3 Any new foreign permanent establishments established during that period could continue to be subject to the new rules immediately.

2.4 Compliance burden

- 2.4.1 The reforms are likely to increase compliance obligations, particularly for SMEs.
- 2.4.2 Businesses may need to undertake more detailed profit attribution calculations under the Authorised OECD Approach than would previously have been necessary in practice. Historically, where double tax relief was available, the precise attribution of profits often had limited impact on the UK tax outcome. The proposed changes may therefore increase compliance costs and complexity for some businesses.

2.5 Small companies and non-qualifying territories

- 2.5.1 We note that the draft legislation continues to exclude from the exemption small companies with permanent establishments in territories that are not full treaty territories.
- 2.5.2 We recognise that the policy concern underlying the reforms may not arise in the same way in these circumstances because the exemption is not available while the company remains small. However, where a company incurs losses while it is small and later grows beyond the small company threshold, future permanent establishment profits may become exempt under the regime.
- 2.5.3 We suggest that consideration should be given to using the reforms as an opportunity to simplify the regime by extending the exemption to small companies with permanent establishments in territories that are not full treaty territories.

2.6 Research and development relief

- 2.6.1 Making the exemption mandatory will prevent UK companies from claiming relief for R&D activities undertaken and expenditure incurred through an overseas permanent establishment because the profits and losses of that permanent establishment will always be excluded from UK corporation tax.
- 2.6.2 We note that this would be restrictive for some UK innovation. However, this change provides sensible simplification and is consistent with more recent policy changes to R&D tax relief which intended to focus support on innovation undertaken in the UK.

3. About Saffery LLP

- 3.1 At Saffery, we're more than just chartered accountants and tax and business advisers. We're a partner-led and people-focused firm, committed to our clients and honouring our heritage.

- 3.2 Since 1855, we've evolved in size and scope, but our unwavering dedication to exceptional client service remains the same.
- 3.3 As a proud member of Nexia, a worldwide network of trusted member firms, we've got access to local insight on a global scale.
- 3.4 In the UK, Saffery LLP is the 15th largest accountancy firm by fee income, with 90+ partners and 1,300+ staff across nine offices. Saffery also has an office in Dublin, Ireland.