

Relief for foreign tax suffered (Lecture B1339 – 22.44 minutes)

Types of foreign tax

Underlying tax

Foreign profit-based tax, e.g. on branch profits, some other PE in that country.

Underlying tax is also deemed to arise on taxable foreign dividends, if the company controls at least 10% of the voting power of the paying company.

In practice, virtually all foreign dividends received by a UK company are exempt from corporation tax, so the underlying tax is not considered.

Withholding tax

The payer must retain local tax at source and pay it to its tax authority and then it pays the net amount to the UK company

Credit relief for foreign tax

A double tax credit may be provided for in a double tax treaty (see later). If not, UK law gives the right to unilateral double tax relief (ss9 – 17 TIOPA 2010) unless expressly prohibited in a double tax treaty (s11(3)).

A claim for credit relief must be made not more than—

- a) 4 years after the end of that accounting period, or
- b) if later, one year after the end of the accounting period in which the foreign tax is paid (s19(3) TIOPA 2010)

Treaty reliefs must be claimed, they are not automatic. For double tax credits this can be done in the CT600.

For withholding tax relief (to minimise the amount deducted), a claim must be made before the relevant payment is made by the payer.

Unilateral relief should be claimed in the CT600, but it is best practice to write to HMRC to confirm that the relief will not be challenged.

Boxes 450, 455 and 460 of the CT600 deal with the amount of double tax relief claimed, whether this includes a claim for underlying tax and whether the claim includes amounts carried back from a later period (as can be the case if the foreign income is from a foreign permanent establishment of the company).

Treaty and unilateral relief

Relief is claimable for the taxes covered by a particular tax treaty

Example

UK-Italy double tax treaty

- Article 2(1)(a)
 - UK (income tax, capital gains tax,) corporation tax and petroleum revenue tax
- Article 2(1)(b)
 - the personal income tax (l'imposta sul reddito delle persone fisiche);
 - the corporate income tax (l'imposta sul reddito delle persone giuridiche);
 - the local income tax (l'imposta locale sui redditi);
 - whether or not collected by withholding at source

But what is the situation for other foreign (in this case, Italian) taxes suffered?

Article 2(2) states that

“This Convention shall also apply to any **identical or substantially similar taxes** which are imposed by either Contracting State **after the date of signature of this Convention** in addition to, or in place of, the taxes of that Contracting State referred to in paragraph (1) of this Article”

Example – IRAP (Imposta Regionale sulle Attività Produttive)

This is an Italian regional tax on production activities. It is a local tax collected by the Region where the production activities liable for tax are conducted.

The standard rate is 3.9% with higher rates for banks and insurance activities and the rate is broadly based on gross margin.

Is this substantially similar to taxes covered in Article 2(1) and was it created after the treaty was signed?

It does not seem to be substantially similar to corporate income tax which is based on total profits chargeable to tax.

In this case, the company should write to HMRC and ask it to confirm that the tax is eligible for unilateral tax relief.

In this case, HMRC replied stating that:

“It is HMRC’s position that the Imposta Regionale Sulle Attività Produttive (“IRAP”) is not a covered tax under the UK-Italy Double Taxation Convention.

However, in line with HMRC Statement of Practice 7/91, we do accept that IRAP is admissible for unilateral double tax relief under section 9 of the Taxation (International and Other Provisions) Act 2010. (Guidance on this can be found in HMRC’s manuals at INTM161030.)

This relief can be claimed in the Corporation Tax return in the same way as treaty DTR - I would recommend including a note explaining the unilateral basis of the DTR”

When double tax credit is not allowed

TIOPA 2010 sets out various situations where a double tax credit cannot be claimed.

1. The foreign tax has been relieved against overseas tax (s25 TIOPA)
2. The company is non-UK resident for tax purposes (s26 TIOPA)
 - Unless the credit is sought by a company resident in the Isle of Man or Channel Islands
3. The person elects for the credit to not be allowed against the tax on the foreign income (s27 TIOPA) - Claiming expense relief instead, for example
4. Credit relief cannot exceed the credit that would have been allowed had all reasonable steps been taken under foreign law or the DTT to minimise the amount of tax payable in the foreign territory (s33)
 - E.g. claiming the benefit of reliefs from tax, making elections
5. Any disallowed credit can be deducted against the foreign income chargeable to UK tax (s35)
 - Includes foreign tax in excess of the limit of credit relief (s42(2))
 - Limit = $R \times IG$ (CT rate x amount of income/gain chargeable)

Example

ABC Limited is UK resident

It has UK income of £1,200,000 and foreign income of £500,000 of which 25% foreign tax has been deducted at source.

Explain how the company will obtain relief for the foreign tax

Analysis

The double tax credit will be allowed up to a maximum of $19\% \times £500,000$, i.e. £95,000

The excess foreign tax that does not get credit relief (£125,000 - £95,000) £30,000 is deductible against the company's total income.

The final CT payable will be:

- UK profits
- Foreign income
- Minus: Excess foreign tax

Profit chargeable

Corporation tax @ 19%

Minus: Double tax relief

UK tax payable

Foreign income where loss relief is available

If a company has foreign income with tax suffered at source, but also has (say) trading losses, its total income could be reduced to zero and it would get no credit relief for the foreign tax suffered.

If the loss relief is current year or carry back relief, the maximum possible loss must be used. To avoid wasting relief for the foreign tax credit, the company can claim expense relief for the foreign tax.

Example

XYZ Limited has foreign income of £200,000 from which 10% foreign tax has been withheld.

It also has a current year trading loss of £350,000 and no other income nor gains.

The foreign income is reduced to zero if the company makes a current year loss claim, so the £20,000 foreign tax could not be credited as there is no UK liability.

The company can claim to deduct the £20,000 tax from the foreign income, reducing it to £180,000

This means that it only needs to use £180,000 of its current loss in the current year claim leaving more loss to either carry back or carry forward.

Time limit for claiming expense relief?

The legislation does not seem to require a formal claim for expense relief. This might mean that it follows the normal rules for amending the CT return, being 12 months after the due filing date (24 months after the end of the relevant period).

What if a company has claimed credit relief in its year ended 31 December 2018, but a later loss arises in the year ended 31 December 2021, which can be carried back under the Covid-19 extension 3 years and reduces the profits of year ended 31 December 2018 to nil?

In hindsight the company would have been better to use expense relief for the foreign tax suffered rather than a double tax credit.

But would it be permitted to amend the return as it is now more than 24 months from the year end?

If the use of expense relief follows the normal amendment window, it appears not, but what we would be doing is reversing the claim for credit relief (for which there is a 4-year window). So it does seem possible in principle to make a claim to use expense relief with hindsight.

Contributed by Malcolm Greenbaum