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By email:

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15th October 2010

Dear Sir,

Re: Foreign branch taxation: discussion document

We are grateful for the opportunity to comment on the above consultation document dated July 2010.

By way of background, the City of London Law Society ("CLLS") represents approximately 13,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees. This response has been prepared by the CLLS Revenue Law Committee.

Our comments on the consultation document are as follows. The questions that we have responded to are those listed at chapter 5 of the consultation document.

Responses to Questions

Scope of exemption

In the case of Option A (an exemption based on treaties), to what extent do you see difficulties arising from disputes with other jurisdictions about the scope of exemption?

The United Kingdom currently has an excellent double tax treaty network, and in our view, this is one of the key attributes of the United Kingdom as a jurisdiction in which

multinational companies can do business. Based on our experience, the number of disputes between jurisdictions over taxing rights is not currently a cause for concern, though we acknowledge that such disputes do arise.

We consider that the technical considerations relevant to such disputes should not be impacted by the introduction of an exemption regime, and so the key question is whether the introduction of an exemption regime will increase the practical likelihood of disputes arising. In our view, an increase in disputes is unlikely. The United Kingdom exempting certain profits should not, in itself, result in an overseas tax authority losing existing taxing rights over such profits. We consider that the preservation of such existing taxing rights will be an important issue in avoiding future disputes between taxing authorities.

Which of Option A and Option B do you prefer, and why?

We agree that the points in the consultation paper concerning the various different issues with Options A and B are well made and valid. We recognise that there are implications of each option that may not be fully understood until the new exemption regime comes into effect.

As stated above, we consider that the United Kingdom tax treaty network is one of the key commercial attributes of the United Kingdom. There is currently a double tax treaty between the United Kingdom and most major jurisdictions in the world, and we consider that the majority of multinational corporate groups will have experience of calculating branch profits in accordance with the applicable treaty. Option A makes use of this extensive treaty network.

We consider that Option B may cause some confusion and involve additional work for taxpayers, on the basis that it may become necessary to perform two sets of calculations in respect of profits generated by the same branch (one for the purposes of the applicable double tax treaty and one for the purposes of the branch profits exemption). We also agree with the point made in the consultation paper that Option B may result in a double taxation or double non taxation issue.

The consultation paper does not appear to indicate how Option A would work in respect of branches located in jurisdictions where no double tax treaty exists with the United Kingdom. We assume, based on the discussion in the consultation paper, that the intention would be for an Option A regime to operate in respect of jurisdictions where there is a double tax treaty with the United Kingdom, and for an Option B regime to operate in respect of jurisdictions where there is no double tax treaty. This is, of course, subject to the outcome of the discussion on whether exemption should be limited to branches in 'treaty' jurisdictions (see below).

We recognise that Option A may involve complexity and additional work in that each foreign jurisdiction (and therefore each applicable double tax treaty) will need to be looked at for the purposes of computing exempt branch profits. However, we consider that a significant number of multinational corporate groups will currently be undertaking these computations. If this is correct, then the amount of additional work should not be significant.

For the reasons stated above, we are in favour of Option A over Option B.

What method do you consider to be most appropriate for attributing capital to the foreign branches of banks, and why?

The consultation paper discusses two potential methods of capital attribution: capital allocation and thin capitalisation. Both banks and insurers are specialist businesses that will communicate their own thoughts to the Government as part of the consultation process. We have, however, set out some general comments below.

The capital allocation approach requires a risk weighting taking into account relevant regulatory requirements. We anticipate that the regulatory landscape impacting on banks (and insurers) is, in the current climate, subject to change over time. If the capital allocation approach is adopted, there should be sufficient flexibility in the approach to allow for any regulatory changes.

It would also be useful to know whether there is any scope to give banks and insurers a choice of approach they can use. This would benefit taxpayers.

What method do you consider to be most appropriate for attributing capital to the foreign branches of insurers, and why?

We refer you to our comments above.

If assets used by a foreign branch were made exempt from chargeable gains, what would be the administrative and compliance impacts?

The consultation paper makes the valid point that anti avoidance issues would need to be considered if a chargeable gains exemption were to be introduced (for example, so as not to allow allocation of assets to a branch immediately before a sale). In addition, the consultation paper points out that certain assets may be used for both branch purposes and 'headquarters' purposes. Notwithstanding these issues, we consider that an exemption for branch chargeable gains is consistent with the overall objective of exempting foreign branch profits from United Kingdom taxation.

We consider that asset identification and apportionment would be a potentially significant practical difficulty with a chargeable gains exemption. It may be difficult in practice for a particular branch to identify the origin of assets (for example, when were assets contributed to the branch from 'headquarters', which assets were contributed etc), and it may also be difficult in practice for a particular branch to determine the extent to which a particular asset is used for 'branch' purposes as opposed to 'headquarters' purposes.

If the Government needs to retain taxing rights over accrued gains, it might be worth considering a regime similar to the intangible fixed assets regime, where only assets transferred to branches after a certain date are exempted from taxation on chargeable gains. This would, however, not be ideal given the general principle that foreign branch assets should be exempt. Alternatively, we consider that a holdover regime could be workable provided that in practice, tax inspectors are prepared to take a 'reasonable' approach in reaching agreement with taxpayers over asset identification and apportionment issues.

Finally, it would be useful to have clarity on which types of chargeable gain are intended to be exempted from United Kingdom tax, and how the proposed chargeable gains exemption will fit with the proposed exemption for business profits. There is, for example, a reference to intangible assets in the consultation paper. Is it the case that gains on intangibles used for purposes of a branch's trade will be exempted under the general exemption for branch profits, whereas intangibles not used for trade purposes will be covered under 'chargeable gains' rules? If a chargeable gains exemption is not introduced, would a consequence be that an analysis would need to be done to

determine which intangibles are used for trade purposes and which are used for non-trade purposes? This could add an extra layer of complexity for businesses.

Is limiting the scope of exemption defined by reference to the CFC rules, or rules equivalent to them (Option C, Option D) a simpler approach than applying the CFC rules to a United Kingdom company with a foreign branch as if the branch were a foreign subsidiary (Option E)?

We consider that applying the CFC rules as if the relevant branch were a foreign subsidiary (Option E) is a more complicated approach than Option D. Option C, which limits the scope of exemption by reference to a CFC based test, is similar to Option E in that both approaches require the assumption that the relevant branch is a foreign subsidiary. This assumption results in some practical difficulties (for example, determining where the place of effective management of the branch is located could be an issue).

The question below concerns the limitation of foreign branch profits exemption to treaty territories. Although this question contains its own issues, we consider that if the exemption were to be limited in such a way then the Government could consider adopting a 'lighter touch' regime in respect of further limiting the foreign branch profits exemption (either by reference to CFC rules or otherwise).

As with the reform of the CFC rules, it is obviously critical to ensure that any limitation on foreign branch tax exemption is compliant with European Union law.

What impact do you consider that limiting the scope of a foreign branch profits exemption to treaty territories would have on United Kingdom competitiveness?

Limiting the scope of a foreign branch profits exemption to treaty territories may have the benefit of making the regime easier to implement (for example, Option A could be adopted without the need to consider the treatment of branches in non-treaty jurisdictions).

However, there are issues that would need to be considered if such a limitation were to be adopted. For example, would branches in any jurisdiction having a double taxation treaty with the United Kingdom be exempt? Or will there be a 'minimum level of taxation' test in a similar vein to the current CFC rules? In practice, given the extent of the United Kingdom treaty network, it may be the case that most branches of United Kingdom tax resident companies are already located in treaty territories. This point could be verified.

How would small companies be affected by the options in this discussion document?

Although our representative clients are not typically small companies, we would expect that small companies should be relatively unaffected by a branch profits exemption, on the basis that many of them will operate solely within the United Kingdom. Nevertheless, some small companies will undoubtedly have foreign branches. We consider that these branches should also benefit from a foreign profits exemption, on the assumption that they undertake commercial activities.

In the case of a profits exemption for small companies, would a generic anti avoidance rule be a more appropriate way to protect Exchequer revenues than a reference to the CFC rules?

As discussed above, our representative clients are not typically small companies. However, we would expect that the majority of small companies operating abroad (through either branches or subsidiaries) are doing so for genuine commercial reasons, rather than tax avoidance purposes.

If this is correct, we consider that most small companies will have a limited understanding of how the CFC rules operate in practice (on the basis that to the extent they have a foreign subsidiary, the motive test is likely to be passed). Referring to the CFC rules would therefore add an extra layer of complexity for small businesses, and we therefore consider that a generic anti avoidance rule would be preferable.

Loss relief

How might an elective regime work in practice?

We recognise that the flexibility of an elective regime will have to be set against the need to prevent the election mechanism being used for anti avoidance purposes.

We also consider that the elective regime is conceptually similar to the option of combining loss relief with a foreign profits exemption subject to claw back, on the basis that the primary purpose of companies making an election will be in order to generate allowable losses.

We consider that the latter option will be preferable to taxpayers, on the basis that they will receive automatic loss relief and will not be required to make a decision on whether to make an election for each relevant branch. It is also likely to be simpler to understand and (at least optically) be less complicated. Similarly, it will be easier for the Government to practically deal with a compulsory, rather than an elective regime.

A key issue with the compulsory regime, as identified in the consultation paper, is how the claw back mechanism should operate (i.e. the choice between Options G and H), and we consider this issue in our response below. The question of whether claw back should operate only where the branch generating the losses becomes profitable, or whether it should operate if an affiliated loss-making branch becomes profitable, should also be considered.

How beneficial would Option G (a claw back mechanism to reclaim loss relief provided) be to businesses?

We refer you to our comments above. We consider that the aim of clawing back loss relief should (as far as possible) be to put the company utilising the losses back in the position it would have been in had those losses not been available. To that extent, it does not seem appropriate to apply DTR to the profits that are taxed in order to apply the claw back. However, any DTR available in respect of the original profits that were relieved by application of the branch losses should be taken into account (to the extent not already taken into account).

How beneficial would Option H (a claw back mechanism to reclaim loss relief provided, without the benefit of DTR) be to businesses?

We refer you to our comments above.

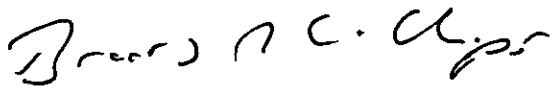
Would Option I, J or K be the most appropriate transitional rule?

We consider that Option I (cancellation of losses) would be the simplest transitional regime to implement, provided that the brought forward branch losses are only available against profits of the same trade and of the same branch (i.e. they would effectively become useless upon the exemption of that branch's profits). Options J (deferral of exemption) and K (claw back pre exemption losses) would be harder to implement in practice. In the case of Option J, for example, the rate that losses will be used by different branches is likely to vary significantly from business to business. It would also be necessary to consider whether Option J would apply separately to each foreign branch where a company has more than one foreign branch.

Do you see any difficulties arising in practice with these options, and if so, what are they?

We refer you to our comments above.

Yours faithfully,



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