United Kingdom/United States Dual Consolidated Loss Competent Authority Agreement

CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME AND ON CAPITAL GAINS

BACKGROUND

Paragraph 3 of Article 26 of the Convention Between the Government of the United States of America and the Government of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital Gains signed at London on July 24, 2001, and subsequently amended by a protocol signed July 19, 2002 ("Treaty") allows the competent authorities of the Contracting States to consult together for the elimination of double taxation in cases not provided for in the Treaty.

The competent authority of each Contracting State recognizes that in certain situations the interaction of domestic loss relief rules can lead to double taxation. Those rules are, in the case of the United States, section 1503(d) of the Internal Revenue Code (Code) and the regulations thereunder, including Treas.

Reg. §1.1503-2(b) and (c)(15)(iv), and, in the case of the United Kingdom, S 403D(1)(c) when subject to 403D(6) ICTA88. These rules are discussed below.

The U.S. Rules

Section 1503(d) of the Code and the regulations thereunder provide that a dual consolidated loss of a corporation cannot reduce the taxable income of any other member of the affiliated group ("domestic affiliate"). A dual consolidated loss is a net operating loss of a domestic corporation that is subject to an income tax of a foreign country on its income without regard to the source of its income, or is subject to tax on a residence basis. Except as discussed below, when section 1503(d) of the Code applies, a dual consolidated loss may only be used to offset income earned by the domestic corporation.

Similar rules apply to any loss of a separate unit of a domestic corporation. A separate unit includes activities of a domestic corporation that constitute a permanent establishment under the terms of a treaty between the United States and the country in which the activities are conducted. For purposes of the dual consolidated loss rules, a separate unit is treated as a domestic corporation and therefore is a domestic affiliate.

Notwithstanding the general rule, a dual consolidated loss may offset income of a domestic affiliate, provided that a taxpayer makes an election and enters into an agreement pursuant to regulations ("(g)(2)(i) agreement") whereby the taxpayer certifies that, inter alia, no portion of the loss has been or will be used to offset the income of any other person under the income tax laws of a foreign country. This election is an annual election made separately with respect

to dual consolidated losses incurred in each taxable year. If a (g)(2)(i) agreement is entered into, and a subsequent “triggering event” occurs (and no exception applies), the taxpayer must generally recapture and report as gross income the total amount of the dual consolidated loss on its U.S. Federal income tax return for the taxable year in which the triggering event occurs, plus an applicable interest charge. Triggering events include, but are not limited to, the use of any portion of the dual consolidated loss by any means to offset the income of any other person under the income tax laws of a foreign country.

The regulations under section 1503(d) of the Code also contain a “mirror legislation” rule that denies the ability to elect to use a dual consolidated loss to offset the income of a domestic affiliate in certain cases. The mirror legislation rule generally applies when a foreign jurisdiction has enacted legislation that operates in a manner similar to the U.S. dual consolidated loss rules and, as a result, prohibits the taxpayer from claiming the dual consolidated loss in the foreign jurisdiction. Section 403D(6) ICTA 88 is mirror legislation within the meaning of the regulations under section 1503(d) of the Code. The mirror legislation rule does not apply, however, to the extent an election is made under Treas. Reg. §1.1503-2(g)(1) to use the loss in the United States pursuant to an agreement entered into between the United States and a foreign country that puts into place an elective procedure through which losses offset income in only one country. The competent authority agreement set forth in this document is an agreement described in Treas. Reg. §1.1503-2(g)(1).

The UK Rules

Section 403D ICTA1988 generally allows for the surrender of the trading losses of UK permanent establishments of foreign companies, but not where that loss is deductible or allowable in any period against profits that are outside the corporation tax jurisdiction of the United Kingdom. No surrender is possible other than in the circumstances permitted. (Section 403D(1)(c) ICTA1988).

The UK legislation also contains a rule (section 403D(6)) that requires any overseas rule which prevents that overseas deduction or allowance by virtue of relief that may be available in the United Kingdom to be disregarded in deciding whether a loss is 'deductible or allowable outside the United Kingdom'. The regulations under section 1503(d) of the Code constitute such a rule. So no surrender of the loss as group relief in the UK is possible.

Section 403D(6) is effective in relation to losses in accounting periods ending on or after April 1, 2000.

Interaction of the Contracting States' Rules

As mentioned, the interaction of the rules described above may result in no relief for a loss in either Contracting State, thereby producing double taxation inconsistent with the aims of Article 7 (Business Profits) and Article 24 (Relief of Double Taxation) of the Treaty and with the intentions of the Contracting States in passing domestic laws to prevent the same loss from being used more than once.

Therefore, to resolve the issue regarding the interaction of the legislation and regulations referred to above, the competent authorities of the Contracting

States agree that certain taxpayers may, subject to the terms and conditions of the competent authority agreement set forth in this document, elect to use, or relieve, losses in either the United States or the United Kingdom to the extent permitted by the rules of the Contracting State, as modified by this agreement.

COMPETENT AUTHORITY AGREEMENT

1. The competent authorities of the United States of America and the United Kingdom hereby enter into the following agreement ("Agreement") regarding, in the case of the United States, dual consolidated losses under section 1503(d) of the Code and, in the case of the United Kingdom, trading losses disallowed under 403D(1)(c) ICTA1988 by the action of S403D(6) ICTA 88, under the Treaty. Except as provided in this paragraph 1, the Agreement applies in cases where a consolidated group of which a domestic owner is a member, or an unaffiliated domestic owner (as such terms are defined in Treas. Reg. §1.1503-2(c)(8), (9) and (11), respectively) ("Taxpayer"), has a permanent establishment in the United Kingdom as defined in Article 5 (Permanent Establishment) of the Treaty ("UK permanent establishment") that incurs losses which, for UK tax purposes, relate to accounting periods ending on or after April 1, 2000, and are otherwise subject to section 1503(d) of the Code and the regulations thereunder, including Treas. Reg. §1.1503-2(b) and (c)(15)(iv), and S 403D(6) ICTA88.[1] This agreement shall not apply where losses are incurred by:

[1] The dual consolidated loss rules do not apply to losses incurred by a U.S. permanent establishment of a foreign corporation. Accordingly, this Agreement does not apply to dual consolidated losses incurred by a permanent establishment of a UK corporation in the United States.

(i) A dual resident corporation within the meaning of Treas. Reg. §1.1503-2(c)(2) (other than to the extent a UK permanent establishment is treated as a dual resident corporation);

(ii) A hybrid entity separate unit, within the meaning of Treas. Reg. §1.1503-2(c)(4); or

(iii) A separate unit, within the meaning of Treas. Reg. §1.1503-2(c)(3), owned indirectly through a hybrid entity separate unit.

2. The Agreement is entered into under paragraph 3 of Article 26 (Mutual Agreement Procedure) of the Treaty.

3. With respect to the United States, and except as provided in paragraph 4 and Annex A of the Agreement, a dual consolidated loss of a UK permanent establishment cannot offset the taxable income of any domestic affiliate as provided under section 1503(d)(1) of the Code and Treas. Reg. §1.1503-2(b) and (c)(15)(iv). With respect to the United Kingdom, and except as provided in paragraph 4 and Annex B of the Agreement, no loss or other amount of a UK permanent establishment shall be treated as available for surrender by way of group relief pursuant to section 403D(1)(c) ICTA 1988.

4. Subject to the terms and conditions of the Agreement, a Taxpayer may elect to:

(i) Use the dual consolidated loss attributable to a UK permanent establishment, within the meaning of Treas. Reg. §1.1503-2(d)(1)(ii), to offset the taxable income of a domestic affiliate, notwithstanding Treas. Reg. §1.1503-2(c)(15)(iv); or

(ii) Surrender a loss of the UK permanent establishment as permitted by S402 ICTA88 and S403D ICTA1988 without the restriction provided by S403D(6),

but may not elect for both treatments. Further, and except as provided in paragraph 4 of each of Annex A and Annex B with respect to losses incurred in certain prior taxable years, no election may be made under this Agreement with respect to a loss unless both the statute of limitations (in the case of the United States) and the time limit for claimant company provided by paragraph 74 of Schedule 18 to FA1998 (in the case of the United Kingdom) have not closed or passed, respectively, with respect to the taxable year or taxable period, respectively, in which such loss was incurred.

5. The election must be made in accordance with the procedures and conditions set out in Annex A or Annex B, as applicable.

6. The use of a loss pursuant to an election under this Agreement must be consistent with the domestic law generally applicable to the relief of losses of the Contracting State in which relief for such loss is sought.

7. In the case of an election for a loss to be used in the United States pursuant to the Agreement and Annex A, the election shall only apply to dual consolidated losses within the meaning of section 1503(d)(2) of the Code and Treas. Reg. §1.1503-2(c)(5). The fact that a particular item taken into account in computing the dual consolidated loss is not taken into account in computing the Taxpayer's taxable income (or loss) in the United Kingdom shall not cause such item to be excluded from the calculation of the dual consolidated loss.

8. In the case of an election for a loss to be used in the United Kingdom, pursuant to the Agreement and Annex B, the election shall apply only to amounts within the terms of S403D ICTA 88. The fact that a particular item taken into account for the purposes of S403D is not taken into account in computing the Taxpayer's taxable income (or loss) in the United States shall not cause such item to be excluded from the calculation of the S403D amount.

9. The election provided under this Agreement is an annual election, applicable with respect to losses incurred in a specific taxable year. A Taxpayer may make only one election under this Agreement with respect to a loss incurred in a particular taxable year. Once made, an election may not be revoked. Taxable year for this purpose refers to the U.S. taxable year of the entity for which a UK permanent establishment exists and which is the subject of this Agreement. If for UK CT purposes, the accounting period of the UK permanent establishment is different from that of the U.S. taxable year for the entity, then an election for a taxable year shall correspond to each accounting period, or part of an accounting period, to which that tax year relates.

10. No part of a loss which has been relieved, used, or claimed in a Contracting State following an election under this Agreement may be utilized for loss relief purposes in the other Contracting State in a manner inconsistent with the domestic law of the first-mentioned Contracting State. Where a loss (or any item composing such loss) has been used in a manner inconsistent with the domestic law of the first-mentioned Contracting State, any loss relief given in the first-mentioned Contracting State will be recoverable or recaptured, where

appropriate, in accordance with the domestic laws of the first-mentioned Contracting State and Annex A or Annex B, as applicable.

11. This Agreement shall be applied taking into account the domestic law of the Contracting States in effect on or before October 6, 2006. In addition, any reference to the domestic law of either Contracting State shall incorporate, when effective, any successor provision of domestic law provided such provision is not materially inconsistent with this Agreement. In the case of the United States, the proposed regulations contained in the notice of proposed rulemaking (REG-102144-04, 2005-25 I.R.B. 1297), that was published in the Federal Register on Tuesday, May 24, 2005 (70 FR 29868), shall, when finalized, be treated as a successor provision that is not materially inconsistent with this Agreement.

12. This Agreement may not be unilaterally terminated by the competent authority of either Contracting State until after December 31, 2011. Prior to such date, this Agreement may only be terminated by the joint agreement of the competent authorities. After December 31, 2011, this Agreement may be unilaterally terminated by the competent authority of either Contracting State providing written notice of such termination to the competent authority of the other Contracting State. If this Agreement is unilaterally terminated by the competent authority of a Contracting State, then such termination will take effect 3 months after the date of the notice of termination. In such event, any election made under this Agreement prior to such termination shall remain valid and in effect with respect to losses covered by such election.

13. It is understood that the competent authorities shall consult together at regular intervals regarding the terms and operation of the Agreement. In addition, the competent authorities may consult regarding the application of specific elections made in accordance with the Agreement. The Agreement will be reviewed in detail in parallel with the arrangements for the Treaty outlined in the Exchange of Notes of July 24, 2001.

Annex A

Election by Taxpayer to Use Losses in the United States

This Annex A provides rules and conditions that must be satisfied for a Taxpayer to use dual consolidated losses in the United States, with respect to which relief is available under the terms of this Agreement, to offset taxable income of a domestic affiliate. It also provides the time, place and manner for various filings and notification required under this Agreement and section 1503(d) of the Code and the regulations thereunder.

1. Compliance with Section 1503(d) and the Regulations Thereunder

The Taxpayer must comply with section 1503(d) of the Code and the regulations thereunder (other than Treas. Reg. §1.1503-2(c)(15)(iv)), as modified in this Agreement. For example, in order to use a dual consolidated loss of a UK permanent establishment to offset taxable income of a domestic affiliate pursuant to this Agreement, the Taxpayer must file an agreement described in Treas. Reg. §1.1503-2T(g)(2)(i), as modified below ("modified (g)(2)(i) agreement").

2. Modified (g)(2)(i) Agreement

The modified (g)(2)(i) agreement must contain the caption "Election under §1.1503-2(g)(1) to Use a Dual Consolidated Loss of a UK Permanent Establishment under US/UK Competent Authority Agreement" at the top of the page. In addition to the requirements described in Treas. Reg. §1.1503-2T(g)(2)(i)(A) through (F), the modified (g)(2)(i) agreement must contain the

following information or representations in paragraphs labeled to correspond with the items set forth below:

(G) The name, address and identifying number of the Taxpayer;

(H) A representation that the dual consolidated loss of the Taxpayer's UK permanent establishment is eligible for relief under the Agreement; and

(I) A representation that if an event described in Treas. Reg. §1.1503-2(g)(2)(iii)(A) occurs, notification of such event will be provided to both the competent authority of the United States and the competent authority of the United Kingdom, as described below.

Except as otherwise provided in this Annex A, a modified (g)(2)(i) agreement must be filed in the same time, place, and manner as a (g)(2)(i) agreement. For example, the Taxpayer must attach the modified (g)(2)(i) agreement to its timely filed U.S. Federal income tax return for the taxable year in which the dual consolidated loss is incurred.

3. Notification to the U.S. and UK Competent Authorities

A copy of the modified (g)(2)(i) agreement must be provided to both the U.S. and UK competent authorities no later than the due date for filing the modified (g)(2)(i) agreement with the Taxpayer's U.S. Federal income tax return, as provided above.

The triggering event notification required under paragraph (I) of the modified (g)(2)(i) agreement must be provided to both the U.S. and UK competent authorities no later than the due date of the Taxpayer's timely filed

U.S. Federal income tax return for the taxable year that includes the event giving rise to such notification (or, when the triggering event is a use of the loss for foreign purposes, the taxable year that includes the last day of the foreign tax year during which such use occurs).

4. Election to Use Dual Consolidated Losses Incurred in Certain Prior Taxable Years

This paragraph 4 of Annex A applies to an election by the Taxpayer to use dual consolidated losses eligible for relief under the Agreement that were incurred in an open taxable year for which the due date (including extensions) for the U.S. Federal income tax return for such year is on or before January 4, 2007. In such a case, and notwithstanding the general time, place and manner rules provided in this Annex A, all agreements, statements, requests, or other information related to such dual consolidated losses that should have been filed on or before January 4, 2007, shall be treated as having been timely filed, provided they are attached to a U.S. Federal income tax return amending the Taxpayer's U.S. Federal income tax return for the taxable year in which they should have been attached. The amended return described in the preceding sentence must be filed on or before the due date of the Taxpayer's U.S. Federal income tax return due for its first taxable year ending after January 4, 2007.

If the statute of limitations is open for a taxable year in which a dual consolidated loss described in this section 4 of Annex A was incurred, the Taxpayer may make an election under paragraph 4(i) of this Agreement, even if the time limit for claimant company provided by paragraph 74 of schedule 18 to

FA1988 with respect to such taxable year has passed. However, such an election cannot be made for a dual consolidated loss that was incurred in a taxable year with respect to which the statute of limitations has closed. See paragraph 4 of Annex B for a similar rule with respect to losses elected to be relieved in the United Kingdom.

With respect to dual consolidated losses incurred in taxable years described in this paragraph 4 of Annex A, a copy of the modified (g)(2)(i) agreement must be provided to both the U.S. and UK competent authorities by the due date set forth above for the filing of the amended U.S. Federal income tax return that included the modified (g)(2)(i) agreement for such losses.

5. <u>Relief for Untimely Filings</u>

In the event that the Taxpayer fails to timely provide or file any agreements, statements, requests, or other information related to dual consolidated losses subject to the Agreement (including a copy of the modified (g)(2)(i) agreement required to be provided to the U.S. and UK competent authorities), relief for such failure shall be available to the extent provided under the general rules of section 1503(d) of the Code and the regulations thereunder, including Treas. Reg. §§301.9100-1 through 301.9100-3, and Notice 2006-13, 2006-8 I.R.B. 496. When applying the foregoing standards to any failure to provide notice to the competent authorities pursuant to this Annex A, relief shall not be given unless and until such notices have been provided.

Annex B

Election by Taxpayer to Use Losses in the United Kingdom

This Annex B provides rules and conditions that must be satisfied for a Taxpayer to apply Section 403D ICTA1988 for the purposes of claiming and surrendering group relief without the application of subsection (6) in respect of U.S. taxation law.

An election by a Taxpayer to use the losses in the UK generally must be made within the time limit for that company to file its Corporation Tax self assessment for the accounting period or accounting periods concerned. However, paragraph 4 contains a special rule pertaining to claim requirements for losses for prior years. If the election affects more than one accounting period, the time limit is the earliest filing date if more than one.

The consent to surrender

1. The company making the election must provide a consent, or as the case may be a modified consent, to surrender under paragraph 71 of Schedule 18 to FA1998.

2. In addition to the requirements which exist under United Kingdom domestic law for a notice of consent to surrender, the following information must be included in the notice of consent otherwise the notice is ineffective:

- Confirmation that an election has been made under this Agreement to elect to disregard 403D(6);
- Confirmation that the amount of relief to be surrendered is eligible for surrender under S403D and an agreement that if that should cease to

be the case, to withdraw the consent in accordance with paragraph 75 of schedule 18 to FA1998;

- Confirmation that notification of the election in accordance with paragraph 4(ii) of this Agreement has been or will be provided to both the competent authority of the United Kingdom and the competent authority of the United States, as described below.

3. Notification to the UK and U.S. Competent Authorities

A copy of the consent or modified consent to surrender must be provided to both the UK and U.S. competent authorities no later than the due date for making the corporation tax self assessment for the UK permanent establishment. Where, notwithstanding an election under paragraph 4(ii) of this Agreement, a loss is not available for surrender by virtue of the operation of the UK rules, a notification of the amended consent to surrender and modified claim must be provided to both the UK and U.S. competent authorities no later than the due date for filing the amended claim.

4. Election to Surrender Losses Incurred in Certain Prior Taxable Years

This section 4 of Annex B applies to an election by the Taxpayer to surrender losses eligible for relief under the Agreement that were incurred in a taxable year for which the due date for Corporation Tax self assessment of the surrendering company for such year is on or before January 4, 2007. In such a case, and notwithstanding the general time, place and manner rules provided in this Annex B, all agreements, statements, requests, or other information related to the surrender of losses that should have been filed on or before January 4,

2007, shall be treated as having been timely filed, provided they are attached to a Corporation Tax self assessment amending its Corporation Tax self assessment for the taxable year in which they should have been attached. The amended claim described in the preceding sentence must be filed on or before the due date of the Taxpayer's Corporation Tax self assessment due for its first taxable year ending after January 4, 2007.

If the period for claimant relief and the Corporation Tax self assessment for such company was due on or before January 4, 2007, is open for a taxable year in which a loss described in this section 4 of Annex B was incurred, the Taxpayer may make an election under paragraph 4(ii) of this Agreement, even if the statute of limitations under United States law with respect to such taxable year has closed. However, losses that are otherwise eligible for relief under this Agreement, that were incurred in an accounting period for which relief was available under section 403D ICTA1988 but for which the time limit for claimant company provided by paragraph 74 of Schedule 18 to FA1998 has passed prior to the date on which this Agreement is entered into, will not be eligible for relief. See paragraph 4 of Annex A for losses elected to be used in the United States.

5. Relief for Late Claims

In the event that the Taxpayer fails to timely provide or file any agreements, statements, requests, or other information related to the surrender of such losses subject to the Agreement (including a copy of the modified consent to surrender to the UK and U.S. competent authorities), relief for such failure shall be available to the extent set out in Statement of practice 5/01.

However any relief which the UK officer of the Board subsequently agrees to be available will not give rise to relief until such notices to the competent authorities pursuant to this Annex B have been provided.