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Legislative Update

UK Tax Authority to Make Foreign Branch Exemption Mandatory

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On 21 May 2026, HMRC published a policy paper proposing significant changes to the UK corporation tax treatment of UK resident companies who conduct part of their business through a foreign permanent establishment (PE).

The newly proposed measures are targeted at UK resident companies that generate large foreign losses, or generate large amounts of capital allowances, in relation to their foreign PEs and then use those reliefs to offset their UK profits.

While the changes apply more broadly, the changes seem to be particularly targeted at companies in the oil and gas sector. The changes will make the foreign branch exemption regime, which is currently elective, mandatory.

Background

The UK's current foreign branch exemption regime was introduced with effect from 2013 as part of a package of measures around that time (including the dividend exemption and CFC reform) to make the UK corporate tax system more territorial and competitive. Under the current regime, a UK resident company may elect for profits and losses attributable to a foreign PE to be excluded from the charge to UK corporation tax.

However, where no election has been made, losses arising in a foreign branch may currently be utilised against a company's UK taxable profits. In such circumstances, HMRC's policy paper identifies potential scenarios where future profits of a company's foreign branch may subsequently fall outside the UK tax net, notwithstanding the prior utilisation of branch losses in the UK. According to the policy paper, this may occur where:

- UK taxation of future branch profits is substantially reduced through the availability of double tax relief; or
- A foreign PE is incorporated once profitable, thereby removing future profits from the scope of UK corporation tax.

The government appears to regard these outcomes as creating an asymmetry between the UK treatment of foreign branch losses and future foreign branch profits.

Proposed Changes

The measures proposed in the policy paper would effectively make the foreign PE exemption mandatory for UK resident companies carrying on activities through foreign PEs. As a result, losses arising in affected foreign PEs would no longer be capable of being offset or otherwise relieved against UK profits. The measures will be published in draft legislation over the summer and are generally intended to have effect for accounting periods beginning on or after 1 January 2027.

However, there will be earlier commencement rules for oil and gas companies. The policy paper states that the new measures will apply from 1 September 2026 for UK resident companies with foreign PEs that carry on activities in connection with the exploration or exploitation of oil and gas. To implement this change, the accounting periods of affected oil and gas companies will be deemed to end on 31 August 2026, with the revised rules applying from the following day.

Practical Considerations

UK groups with existing or proposed overseas operations conducted through foreign branches should consider:

- Whether foreign branch losses are currently expected to be available for UK relief.
- The timing of anticipated losses and profits arising in foreign PEs.
- Whether existing structures involving foreign branches remain appropriate.
- The potential implications of any planned incorporation or restructuring of foreign operations.

The policy paper is available on HMRC's website [here](#).

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