

## Introduction

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Companies pay corporation tax on their income and capital gains. Corporation tax also applies to most clubs, societies and associations, and to overseas companies that are either resident in the UK or trade in the UK. Companies and others within corporation tax are required to self-assess their own tax liabilities. The self-assessment system for companies is similar to self-assessment for individuals, although the relevant dates differ.

Calculation of the amount of taxable income and gains for companies is based on the same principles as for individuals, but there are many special rules for companies.

This topic covers the main rules of corporation tax. It also gives some general tax planning guidance, although companies should always obtain professional advice on particular situations.

## The basic rules

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Corporation tax is charged on trading and investment income, and on capital gains. Investment income does not generally include dividends received from other companies.

### The rates of tax

The rates of corporation tax are set for a financial year. The financial year 2011 is the year beginning 1 April 2011 and ending 31 March 2012.

- Where a company's accounting period straddles two financial years, and the tax rates change, its profits are apportioned on a time basis between the two financial years and then charged to tax at the rates applicable for each financial year.
- There are two rates of corporation tax:
  - The main rate, paid on profits above an upper limit, which for many years has been £1.5 million. Where profits are more than the upper limit, the whole of the profits is taxed at the main rate.
  - The small profits rate, paid on profits up to £300,000.
- Where profits fall between £300,000 and £1.5 million, the profits are charged in the first instance at the main rate. Then a 'marginal relief' is deducted. So a company whose profits are within the marginal relief band pays a lower overall percentage than the rate of the band above.
- The way in which these rules work means that the effective marginal tax rate on profits between the limits is higher than the rate of the next band up – see the table below.
- The main and small profits tax rates have converged and are presently 6% apart (financial year 2011). The intention is that there will be both a reduction and a further convergence over the next four years. The effective marginal rate is presently 1.50% above the main rate.
- Where companies' taxable profits fluctuate above and below £300,000, they may wish to consider any available ways of controlling the timing of income, expenses and claims for tax reliefs to reduce taxable profits in those years where they would otherwise exceed £300,000.
- The rates and limits for the financial years 2010 and 2011 are set out below:

Rate	Profits £	Effective marginal rate 2010	Effective marginal rate 2011
Small companies'	Up to 300,000	21%	20%
Marginal	300,001 – 1,500,000	29.75%	27.50%
Main	1,500,001 and over	28%	26%

- The limits are proportionately reduced for periods of less than 12 months.
- The corporation tax calculation must be carried out using the statutory method, i.e. deducting marginal relief.
- Dividend income is not taxable as such but it has the effect of reducing the limits as they apply to the company's taxable profits.
- Companies must claim the small profits rate or marginal relief. Completion of form CT600 (the corporation tax return – see the separate topic 'Corporation tax') and the accompanying tax computation is accepted as a valid claim; this shows the tax calculated at a lower rate or marginal rate.

#### Example 25.1 – Corporation tax liabilities (1)

Company A has profits of £200,000 for the year ending 30 September 2011.

Its corporation tax liability is:

FY 2010 (1.10.10 – 31.3.11) 6/12ths of £200,000	
£100,000 × 21%	£21,000
FY 2011 (1.4.11 – 30.9.11) 6/12ths of £200,000	
£100,000 × 20%	£20,000
<b>Total</b>	<b>£41,000</b>

#### Example 25.2 – Corporation tax liabilities (2)

Company B has profits of £500,000 for the year ending 31 March 2011.

Its corporation tax liability is:

£300,000 × 20%	£60,000
£200,000 × 27.5%	£55,000
<b>Total</b>	<b>£115,000</b>

## Future years

The main rate of corporation tax will fall to 25% for the financial year 2012, 24% for 2013 and 23% for 2014.

It is proposed that from April 2011 and for subsequent financial years, the small profits rate will be 20%. The consequence is that the marginal rate will fall from 29.75% to 27.5%, 26.25%, 25% and finally to 23.75%.

## **Accounting periods**

Corporation tax is charged for accounting periods, which are never longer than 12 months. The accounting period is normally the same as the year for which a company makes up its accounts. Where a company makes up one set of accounts for, say, 15 months, there is a 12-month accounting period, followed by a three-month accounting period.

## **Capital gains**

Companies, unlike individuals, do not pay capital gains tax (CGT) as a separate tax.

- Capital gains and losses are calculated according to the CGT rules, with several modifications, but the tax comes within the corporation tax charge.
- Net chargeable gains are added to the company's income to arrive at the total profits, which are then subject to corporation tax.
- Unlike individuals, companies benefit from indexation relief on disposals, under which base acquisition values are revalued in line with movements in the retail prices index (RPI).
- Unrelieved capital losses cannot normally be set against trading profits or other income, but they can be carried forward and set against future capital gains.
- There is no annual capital gains exemption for companies.

## **Associated companies**

Where several companies are associated with each other, the band limits for corporation tax are divided by the number of associated companies. Therefore, the main rate of corporation tax becomes payable at a lower level of profits.

- Associated companies for this purpose are broadly those where one company has control of the other, or both are under common control.
- There need not be a parent and subsidiary company relationship. The control may be exercised through related individuals such as a married couple. However, for accounting periods ending after 31 March 2011 control will not be exercised through two or more individuals unless there is substantial commercial interdependence between the companies concerned. This should avoid companies being associated because of the existence of a personal relationship between the controlling shareholders. However, some companies may become associated due to the operation of the new commercial interdependence rules, in which case those companies may elect for the new rules to apply for accounting periods beginning on or after 1 April 2011.
- An associated company is counted even if it was associated for only part of the accounting period, and two or more are counted even if they were associated for different parts of the accounting period.
- An associated company is counted regardless of where in the world it is incorporated or resident.
- An associated company is disregarded if it has not carried on any trade or business at any time in that accounting period, or in the part of the accounting period when it was associated.

- In practice, HM Revenue & Customs (HMRC) disregards a non-trading holding company if it has:
  - No assets other than shares in its subsidiaries.
  - No income or gains, other than dividends distributed in full to shareholders and which either are, or could be, group income or foreign income dividends.
  - No entitlement to a deduction for charges or management expenses.
- A claim for the small profits rate of corporation tax on form CT600 must state the number of associated companies.

## Self-assessment

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Companies have to self-assess their corporation tax. The key features of corporation tax self-assessment are:

- Companies must complete a self-assessment tax return, including a calculation of tax liability.
- The information given to HMRC is processed immediately and is not checked until later.
- The tax liability of a close company on loans to participators must be included in the self-assessment.
- The liabilities in respect of controlled foreign companies must be included in the self-assessment.
- Large companies must self-assess using the transfer pricing and thin capitalisation legislation, without being told to do so by HMRC.
- Companies must notify HMRC within three months of becoming chargeable to tax either for the first time or after a period of not being chargeable.

### Payment of corporation tax

Under self-assessment, the date on which corporation tax has to be paid depends on whether the company's profits are more than the upper limit (£1.5 million). This limit is proportionately reduced where there are associated companies or where the company's accounting period is less than 12 months long.

- Where a company's profits are not more than the upper limit, corporation tax is payable nine months and one day after the end of the accounting period.
- If a company's profit is above the upper limit, quarterly instalment payments have to be made.
  - Any company where the corporation tax liability is less than £10,000 need not make quarterly payments.
  - Companies do not have to make instalment payments in the first period in which their profits exceed the upper limit, unless the profits of that period are more than £10 million.
- The payments are normally made as follows:
  - The first instalment is six months and 13 days after the start of the accounting period, therefore normally on the 14th day of the seventh month of the accounting period.
  - The second instalment is three months after the first instalment.



- The flat-rate penalty for late returns is due even if there is no tax liability.
- There are also tax-related penalties for returns over six months late:
  - Six to 12 months after the filing date 10%
  - Over 12 months after the filing date 20%
- Although HMRC has the power to reduce or remit penalties, it will not do so unless the company has a reasonable excuse for the return being late.
- The company can appeal to the Tax Tribunal against any penalties. The Tribunal is part of the judicial system.
- The new rules will include penalties for late payment of tax. There will be a penalty of 5% of the amount unpaid, generally one month after the payment due date, and further 5% penalties of the tax still unpaid at six and 12 months after the due date. These have only partly been brought into effect.

## Other penalties

There are additional penalties for incorrect returns and other failings:

- For deliberately understating instalment payments or paying those instalment payments late.
- For failing to keep proper accounting records, the maximum penalty is £3,000.
- For failing to produce documents, the penalty is £50, plus daily penalties of a maximum of £30 a day if determined by HMRC, and £150 a day if determined by the Tax Tribunal.
- For failing to notify that a company is chargeable to tax within 12 months of the accounting date end.
- For incorrect tax returns, accounts and claims, a penalty arises if:
  - The document contains an error that leads to understated tax, a false or inflated statement of a loss or a false or inflated repayment claim.
  - The error is careless, deliberate, or deliberate and concealed.
- The penalties for incorrect returns and failing to notify are a percentage of the potential lost tax.
  - There is no penalty if a person takes reasonable care but submits an incorrect return. However, if they later discover the error and do not take reasonable steps to inform HMRC, the error will be treated as careless.
  - The penalty is up to 30% of the lost tax for a careless error.
  - It is up to 70% of the tax for a deliberate but unconcealed error.
  - It is up to 100% of the tax for an error that is deliberate and concealed.
- The penalties are substantially reduced if the company discloses the error before HMRC makes enquiries and provides sufficient information so that HMRC can fully quantify the tax lost.

- Penalties for careless errors in tax returns or other documents may be suspended for up to two years. If the conditions for the suspension are met the penalty is cancelled.
- These penalties are the same for most of the direct and indirect taxes administered by HMRC.

## **Enquiries and checks**

HMRC has the automatic right to enquire into any return within one year after delivery of the tax return to HMRC, with two exceptions:

- Where companies form a large group (as defined under the Companies Act 2006), the enquiry period is one year after the filing date (equivalent to two years after the end of the accounting period). This is to allow time for HMRC to look at their returns together.
- If the tax return has been submitted late, HMRC has, until the end of the quarter following the first anniversary of the date the return was delivered, the right to open an enquiry.

Once this period has elapsed, HMRC can only start an enquiry into an earlier year's return if:

- It makes a discovery that an assessment is incorrect, and this was brought about carelessly or deliberately by the company or its agents, or
- Because information supplied on or with the return was insufficient to enable HMRC to decide that the assessment was incorrect within the normal period for opening an enquiry.

Companies should therefore supply enough information with the CT600 to protect themselves from an enquiry after the normal time limit. The information must be enough to show clearly that the return may be wrong. For example, if a valuation has been used to reach the amount of tax due, full details of the circumstances of the valuation must be given, including the details of the valuer and the basis on which the valuation was carried out.

HMRC is likely to target companies where there is a greater risk that the tax return contains errors or is incorrect.

This is likely to include such risk factors as a company's tax compliance record, cash-based businesses, and frequent transactions with overseas companies.

HMRC can carry out a pre-return check on the company's records before it has submitted a tax return. These checks are carried out only where HMRC has identified a risk such as the use of a tax avoidance scheme or fraud.

## **Capital allowances**

Companies are entitled to the same capital allowances as unincorporated businesses. Claims for capital allowances must be made on form CT600. Any amendments must be made on an amended self-assessment return.

## **Tax credits**

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Dividends paid by UK companies carry a tax credit equal to one-ninth of the dividend, that is, 10% of the deemed gross dividend. The tax credit does not depend on the company paying enough (or any) corporation tax.

- Shareholders with no tax liability cannot reclaim the tax credit.
- Individual shareholders whose income is within the basic rate tax band are liable to income tax at 10% on their dividend income: so the tax credit satisfies their UK tax liability on dividends.

- The higher rate of income tax on dividend income is 32.5%. This rate ensures that higher rate taxpayers pay the same amount of additional tax on their dividends as they would on an equal sum of net interest.
- The additional rate of income tax on dividend income is 42.5%, which applies to those with taxable income in excess of £150,000.
- UK companies that receive UK dividends generally do not have to pay corporation tax on that income, with the exception of financial traders.

## Loans to participators

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There are special rules that charge tax when a 'close' company makes a loan to a 'participator'. Broadly, a participator is a shareholder, but some types of loan creditors can also be participators. A close company is a company controlled by its directors or by five or fewer participators.

- If a company makes a loan to a participator, the company pays tax at a rate of 25% on the amount of the loan or advance that is outstanding at the end of the accounting period.
- If the loan is repaid, the tax can be reclaimed.
- The tax becomes payable by the company nine months after the end of the accounting period in which the loan is made.
- Tax does not need to be paid at all if the loan is repaid before the tax falls due.
- If the loan is repaid after the tax falls due, the tax will be due for repayment nine months after the end of the accounting period in which the loan is repaid.
- If the loan is released then a corporation tax deduction is not available under the loan relationship rules for the release.

## Trading losses

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Companies that make trading losses can offset them against income and gains of the same year, carry them back to earlier years, or carry them forward to be set against future profits of the same trade.

- In general, the carry-back of a loss is limited to the immediately preceding year.
- A temporary extension to this relief allows companies to carry back losses for up to three years, with later years' profits being relieved first.
- Only losses for company accounting periods ending between 24 November 2008 and 23 November 2010 can be carried back more than one year.
- The amount of losses that can be carried back to the immediately preceding year is unlimited. After carry-back to the immediately preceding year, a maximum of £50,000 of any unused losses from the same accounting period is available for carry-back to the earlier two years.

The carry-back claim is made in the self-assessment return. Once the return becomes final, these figures also become final.

## **Groups of companies**

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There are special rules for companies in a group. The precise definition varies depending upon the specific relief. A group exists for corporation tax purposes where one company owns 75% of the other or a third company owns 75% of each of them. Companies can form a group for tax purposes even if not all of them are UK resident. For example, UK companies with a non-resident parent company can benefit from group tax reliefs.

### **Group relief**

Trading losses and other eligible items in one company can be set against profits in another UK group company. Claims must be made on the corporation tax return form CT600. The amount of relief must be specified in a precise way.

Group relief is extended to non-resident companies carrying on a trade in the UK through a branch. Group relief also extends to losses arising in the European Economic Area provided there is no possibility of relief in the country in which the loss was incurred or any other country.

### **Rollover relief**

A capital gain from the sale of a business asset in one company can be rolled over against the purchase of a business asset in another group company, and the tax can be deferred. This relief is also extended to allow rollover into the UK branch of a non-resident company. Similar rules apply to rollover relief on sales of intangible assets such as goodwill, which are taxed as revenue (see the separate topic 'Corporation tax').

### **Transfer of capital assets**

Capital assets can be transferred from one company to another in the group on a no gain/no loss basis. This advantage is available to groups of companies in a worldwide group as long as the asset remains within the charge to corporation tax on chargeable gains. It is also possible to elect that a gain or loss on a disposal of an asset made by a group company be transferred to a different group company, in effect allowing group relief for capital gains and losses.

### **Transfer of trade with losses carried forward**

Losses can generally be transferred from one company to another in the group without any tax charge.

### **Substantial shareholding exemption**

The disposal of shareholdings in qualifying trading companies are exempt – see the separate topic 'Corporation tax'. The definition of a group of companies is as for CGT but with an ownership requirement of 51% rather than 75%.

### **Stamp duty land tax (SDLT)**

Transfers of land interests within a group of companies and certain reorganisations are relieved from SDLT.

There are number of anti-avoidance rules, and clawback rules, where the seller and buyer subsequently cease to be members of the same group of companies and where there is a change in control of the buyer following the seller ceasing to be a member of the group.

## Close investment-holding companies

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A close investment-holding company is broadly a company controlled by five or fewer people and their associates that does not trade but has investment income.

- Companies that have interests in land that is let or intended to be let, and holding companies of trading subsidiaries, are not close investment-holding companies.
- Special restrictions apply to close investment-holding companies. In particular, they pay corporation tax at the main (26%) rate, regardless of the size of their profits.

## Company residence

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The residence of companies is an important factor in determining their liability to UK corporation tax.

### UK-resident companies

All companies that are UK resident are liable to UK corporation tax. All companies incorporated in the UK since 15 March 1988 are UK resident, with a few limited exceptions.

Companies incorporated in the UK before 15 March 1988 and all companies, even if they are registered overseas, are UK resident if their central management and control is exercised in the UK.

- UK-resident companies are taxed on all their income and gains regardless of whether they arise in the UK or overseas.
- Where the company has paid foreign tax on overseas income, double taxation relief may be available.
- The underlying tax rate on dividends received from a company is capped at a rate equal to the UK corporation tax rate, but there are limited provisions for 'pooling' of tax credits.
- Dividends received after 30 June 2009 are generally exempt from corporation tax.
- Companies can carry back unrelieved foreign tax credits for up to three years and carry them forward indefinitely.

### Non-resident companies

Companies that are not UK resident but are trading in the UK through a 'permanent establishment' are liable to UK corporation tax on the income or gains arising from that trading activity.

## Controlled foreign companies

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There are special rules where UK-resident companies or individuals control an overseas company, and the overseas company is resident in a low tax jurisdiction.

- The overseas territory is counted as a low tax jurisdiction if the overseas tax paid is less than 75% of the equivalent UK tax. There is a published list of territories that are not counted as low tax jurisdictions for this purpose.
- Any UK company that controls more than 10% of an overseas company in a low tax jurisdiction will have part of the overseas income apportioned to it and is liable to UK corporation tax on that income.

Some exemptions are available, for example, if the overseas company passes the 'acceptable distribution' test by distributing at least 90% of its profits. This exemption is not available for accounting periods starting after 30 June 2009.

## Other points

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### Intangible assets

Tax relief is given to companies for purchases of, and expenditure on, intellectual property, goodwill and other intangible assets from 1 April 2002.

- The relief is based on the amortisation (depreciation) shown in the accounts, provided this reflects an acceptable accounting practice. Alternatively, companies can opt for relief at 4% a year, for example, if the expenditure is not amortised.
- Disposals of intangible assets will normally give rise to taxable income or an allowable deduction, calculated as the difference between the disposal proceeds and the tax written-down value.
- A rollover relief is available where disposal proceeds are reinvested in other intangible assets within a period starting 12 months before and ending three years after the disposal. Several conditions must be met:
  - A group is treated as one company for the purpose of rollover relief.
  - Rollover relief can extend to the purchase of shares in a company that becomes a member of the group and itself owns intangible assets acquired or created after 31 March 2002.
- Transfers of intellectual property within a group of companies are tax-neutral.
- Intangible assets purchased before 1 April 2002 generally continue to be taxed under the capital gains rules, under which there is no relief for amortisation. However, with very limited exceptions, rollover relief is not available under the old or new rules for these 'old' intangible assets.
  - Goodwill generated internally by the business remains under the CGT rules if the business started before 1 April 2002.
  - Goodwill acquired from a related party, for example, where an individual incorporates a business carried on as a sole trader, remains under the old rules if the related party started the business before 1 April 2002.
- Goodwill, the various agricultural quotas and payment entitlement under the single payment scheme for farmers are no longer qualifying assets for companies under the capital gains rollover relief rules.

### Disposals of substantial shareholdings

Companies are exempt from tax on certain disposals of shares.

- The company selling the shares must be a trading company or member of a trading group (see the separate topic 'Corporation tax').
- The seller must have owned at least 10% of the company in which shares are being sold for a period of 12 months within the 24 months before the sale.
- The company in which the shares are being sold must have been a trading company or holding company of a trading group since the beginning of the 12-month period in which the seller satisfied the 10% ownership requirement.

- Both the seller company and the company whose shares are being sold must retain their trading status immediately after the sale. This tax exemption is intended mainly to benefit disposals that benefit trading activities.
- The exemption is denied in certain cases where the sole or main benefit of the disposal is to take advantage of the exemption.
- Where the disposal meets the conditions for the exemption, any loss is not allowable.

## Research and development

Companies benefit from enhanced tax relief for revenue expenditure on research and development. Small and medium-sized companies (SMEs) are given tax relief on 200% of the actual costs (175% for expenditure before 1 April 2011), and large companies on 130% of costs incurred.

- Research and development means activities treated as such under normal UK company accounting practice. The expenditure must be incurred on staffing costs, consumable stores, certain overhead costs or sub-contracted work, and be related to a trade carried on by the company or be expenditure from which it is intended that such a trade will be derived.
- A company is small or medium-sized for this purpose if it, together with any other company in which it holds more than 25% of the capital or voting rights, has fewer than 500 employees and meets at least one of the following conditions:
  - Annual turnover is not more than €100 million (approximately £84 million).
  - Assets are not more than €86 million (£72 million).
- Relief is only given if qualifying expenditure is at least £10,000 in the year. The limit is reduced pro rata for shorter accounting periods.
- If the expenditure gives rise to an unrelieved trading loss, and the company is a small or medium company, the company can claim payment of a tax credit instead of carrying the loss forward.

## Expenses of managing investments

Tax relief is given for the costs of managing investments, including staff costs.

Normally, no expenses are deductible directly from income, such as interest and dividends from investments, and the cost of managing investments is not deductible directly from any trading or property letting income of the company because it is not an expense of the trade or letting business.

Management expenses are deductible from the company's income and gains as a whole in arriving at profit chargeable to corporation tax.

If management expenses are more than the company's income, the excess is carried forward and deducted from income of later periods.

## Special transactions

There are special rules for transactions that companies might occasionally wish to undertake, such as reconstruction, demergers and purchasing their own shares. Specialist advice should always be taken on these points.

Special rules also apply to debits and credits arising in connection with loans and to foreign exchange profits and losses.

## Other entities

There are special rules for banks, building societies, housing associations, life assurance companies, oil extraction and exploration companies, charities that trade, community amateur sports clubs (CASCs), open-ended investment companies (OEICs) and unit and investment trusts.

## Tax planning key points

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- The phased reduction in corporation tax rates is important in determining timing of income. Further, the reduction in capital allowances will encourage businesses to accelerate some capital expenditure.
- Companies, and particularly groups, should try to ensure that they are not paying a higher rate of corporation tax than necessary. In particular, it is important to consider:
  - The timing of income and expenses and group transactions.
  - The use of trading losses, particularly in group structures.
  - The special rules regarding finance costs, intangibles (e.g. acquired goodwill), research and development, disposals of certain shares (substantial shareholdings), controlled foreign companies, transfer pricing arrangements, etc.
- Owner-controlled companies, where the shareholders and directors are often the same people, should consider corporation tax in conjunction with the personal tax position of the owners.
- With the self-assessment system, companies must ensure that their accounting systems can provide the information necessary to compute the corporation tax and file the tax return within the time limits. There are interest and penalties for late payment and/or late filing of returns.

*This guide is for general information only and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from taking action on the basis of the contents of this publication. The guide represents our understanding of the law and HM Revenue & Customs practice as at September 2011, which are subject to change.*