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Doing Business in the United Kingdom

PART VI TAXATION
CHAPTER 25 Taxation of Companies

2-25 Doing Business in the United Kingdom § 25.02

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§ 25.02 Charge to Corporation Tax

[1] Accounting Periods

Corporation tax liability arises by reference to a company's accounting period.n1 An accounting period for these purposes will usually be the period for which the company makes up its accounts. However, an accounting period may not exceed 12 months: thus if a company prepares accounts for a period of, say, 18 months, the first 12 months will constitute one accounting period and the remaining 6 months will be treated as another accounting period. The first accounting period of a UK resident company will begin when the company commences business or acquires some other source of income. The first accounting period of a non-UK resident company will begin when it establishes a trading permanent establishment in the UK. An accounting period will end on the expiration of 12 months from the beginning of the accounting period (unless the company makes up accounts to an earlier date) or, if earlier, on the occurrence of any of the following events: (1) the company beginning or ceasing to trade; (2) the company beginning or ceasing to be resident in the UK; or (3) the company going into liquidation. The issue of a company's accounting period recommencing after ceasing to trade, came before the House of Lordsn2 who had to decide if a company had an accounting period to which a claim for repayment of advance corporation tax could be related. The House of Lords held that the company was within the charge to corporation tax, that a new accounting periodn3 had commenced when a dividend was paid. They held that the payment of the dividend had created a liability to pay Corporation Tax and that therefore the company was by definition "within the charge to corporation tax"n4 as required for the purposes of the claim to set-off the surplus advance corporation tax against corporation tax paid in earlier years.

[2] Date for Payment

The 1993 "Pay and File" system of corporation tax was replaced by the "self-assessment" system for accounting periods ending after 1 July 1999n5 under which the previous corporation tax payment date, of 9 months after the end of the accounting period, is as a general rule retained (except for large companies). Return forms and the computation of corporation tax payable are due for submission to HMRC no later than 12 months after the end of the accounting period, although as a general rule payment is due 3 months earlier.n6 The computation of corporation tax constitutes the "self-assessment" and must include all the relevant claims relating to the accounting period, such as group relief and capital allowances.

Under the self-assessment system, large companies (defined as those liable to corporation tax on profits of at least £1.5m) are required to make payments of corporation tax in four instalments, two instalments falling due during the accounting period and two falling due after the end of the period.n7 For accounting periods ending on or after 1 July 2005, Oil and Gas companies are required to make payment of corporation tax in only three instalments.n8 The instalments system effectively replaces advance corporation tax on company distributions, which was abolished with effect from 6 April 1999.n9 The instalments are, perhaps surprisingly, based on the current year's profits and therefore require companies to make accurate assessments of current profit trends. This can lead to interest payments on inaccurately calculated instalments. The instalment regulations also include the power to levy penalties for failure to pay the correct amount based on its current estimate or for failure to remedy this or to make payment at the correct time.n10

Interest on tax due will begin to run from the end of the nine-month period or from the date on which instalments fall due.n11 It is important to note that the rate of interest charged on overdue tax is higher than that paid by the Inland Revenue on tax overpaid. As companies may not know with any certainty what their correct tax liability will be at the time of payment, they have to consider carefully whether to lean towards overpayment rather than underpayment of tax. Unlike interest on late payment of income tax, interest on late payment of corporation tax is deductible as a business expense.n12 It should be noted that changes in the rate of interest no longer require a formal amendment to the statutory instrument but they are set by an announcement (treated as an "Order") by HMRC.n13

[3] Rate of Tax

The rate of corporation tax is normally set annually in advance by reference to financial years. A financial year begins on 1 April and ends on the following 31 March and is known by the calendar year in which it begins. Thus, the year beginning 1 April 2008 is known as the financial year 2008.The main rate of corporation tax for the financial years 2000 to 2007 was set at 30% but has been reduced to 28% for the financial year 2008..n14 As discussed earlier,n15 lower rates of corporation tax apply to companies with profits below £1.5million (the "small companies rate"), consisting of a raten16 of 20% for companies with profits up to £300,000 and a tapering marginal rate of 32.5% for profits between £300,000 and £1.5 million. "Profits" include "franked investment income."n17

As discussed in Chapter 24, a starting rate of NIL, for companies with profits up to £10,000 was abolished from Financial Year 2006 onwards. Similarly a non-corporate distribution rate of 19%, having been introduced by FA 2004 in respect of distributions made after 31 March 2004 and principally affecting only companies with profits up to £10,000, was likewise abolished from 2006 onwards.n18

Capital gains are charged to corporation tax at the same rate as a company's income for the same accounting period.

The reduced corporation tax rate (the "small companies rate") will apply to a company's profits where they do not exceed certain limits for a given accounting period and provided the company is not a close investment holding company.n19 For this purpose "profits" include not only capital gains but also dividends received from other UK resident companies (other than "group" companies). Also excluded from the definition of profits is franked investment income passing between two UK subsidiaries of a non-resident parent company.n20 If a company's profits are below £300,000 (financial year 2007) its profits are taxed at 20%. If its profits exceed £1,500,000 (financial year 2007), there is no reduced rate. If its profits fall between these two figures, a form of tapering relief is given whereby the corporation tax charged on the company's profits is reduced by a fraction of the difference between £300,000 and the company's profits. This fraction is 1/40th for year 2007 and the marginal rate of tax on taxable profits between those limits is 32.5% for that year.n21

Where a company has "associated companies" (whether or not UK resident) the figures of £300,000 and £1,500,000 must be divided by one plus the number of those associated companies. Thus if a company has three associated

companies it will not be able to take advantage of the 19% rate for 2006 unless its profits are no more than £75,000 (£300,000), and the company will pay corporation tax at the full rate of 30% if its profits exceed £375,000. Companies are "associated" when one is under the control of the other, or both are under the control of the same third party.n22 In practice, therefore, it is unlikely that a UK subsidiary company of all but the smallest multinational group will be entitled to this lower corporation tax rate. For the test of being associated, a company which has not carried ona trade in the relevant accounting period is disregarded.n23The reduced small companies' rates is in principle only available where the company is resident in the UK. Where, however, a double taxation convention applies, the Inland Revenue interpret the non-discrimination paragraph appearing in many conventions as entitling a company which is not resident in the UK but is resident in the other state, to the benefit of this reduced rate, where appropriate. In addition, the decision of the ECJ in *R v. IRC ex p. Commerzbank AG* n24 led to permanent establishments of companies of another EC Member State establishing a right to the reduced rate of corporation tax, on the basis of non-discrimination under the Treaty of Rome. Such non-discrimination is subject to the *Bachmann* decision of the European Court of Justice,n25 which allows tax discrimination on the basis of "tax cohesion," but is a clear limitation on the extent to which residence or non-residence is a criterion for any particular tax treatment.n26

[4] Self-assessment

As noted at § 25.02[2], the Pay and File system was converted to a full Self-assessment system of corporation tax for accounting periods ending on or after 1 July 1999. The assessment is no longer made and served by the Inspector of Taxes, but arises from the process of self-assessment itself. Under self-assessment, companies are required, when filing their return, to compute their tax liability and make payment without further formal application by HMRC. This computation serves as a formal assessment for the purposes of the Taxes Management Act and replaces the need for the issue of a formal assessment by the authorities. HMRC have the power to conduct selective audits of self-assessment returns, in addition to challenging the returns on the basis of information received. Self-assessment removes the need for certain formalities and the process must include all relevant claims, such as group relief, for which other filing requirements previously applied. In addition, other matters which depended upon HMRC taking the initiative must now be taken into account by the company when completing its self-assessment return. These include the obligation to report profits on transactions between associated companies on the basis of an arm's length transaction--the "transfer pricing" regimen27 and reporting any liability to tax under the "controlled foreign companies" provisions.n28 In both of these situations, the onus for taking action to assess tax has switched from HMRC to the taxpayer company. The self-assessment must also include any tax due on loans to participators of close companies.n29

FOOTNOTES:

(n1)Footnote 1. ICTA 1988 ss.8 and 12.

(n2)Footnote 2. *Walker v. Centaur Clothes Group Ltd. [2000] STC 324.*

(n3)Footnote 3. ICTA 1988 section 12(2)(a).

(n4)Footnote 4. ICTA 1988 s.832(1).

(n5)Footnote 5. *See* FA 1998 Schs.18 & 19; *§ 25.02[4] infra* .

(n6)Footnote 6. FA 1998 Sch.18 paras. 37 & 14.

(n7)Footnote 7. Corporation Tax (Instalment Payments) Regs 1998 - SI 1998/3175 and TMA 1970 s.59E, inserted by Finance and 1998 section 30.

(n8)Footnote 8. Corporation Tax (Instalment Payments) Regs.2005 - S.I.2005/889 amending S.I.998/3175.

(n9)Footnote 9. FA 1998 s.31.

(n10)Footnote 10. Corporation Tax (Instalment Payments) Regs 1998 - SI 1998/3175 Reg 13.

(n11)Footnote 11. TMA 1970 s.87A(1A).

(n12)Footnote 12. TMA 1970 s.90(2).

(n13)Footnote 13. Current CT instalment rates of interest were set by an Order effective from 6 January 2008 at 5.75% , replacing a rate of 6.5% which applied from 6 August 2007.

(n14)Footnote 14. FA 2007 s2(1)(a) and See FA 2006 s.24. The exception is for ring-fenced profits of oil and gas companies which remain taxed at 30%. - FA 2007 s2(1)(b

(n15)Footnote 15. *See § 24.01[2] supra*.

(n16)Footnote 16. FA 2007 s3(1) (a); For financial year 2006 the rate was 19% the corresponding marginal rate was 32.75% for profits up to £300,000. .

(n17)Footnote 17. *See § 25.03[3][b]* and *25.03[4][b] infra* .

(n18)Footnote 18. ICTA 1988 s.13AB and Sch A2, introduced by FA 2004 s.28 and Sch.3, as amended by FA 2005 s.13. *See § 25.03[3][f] infra*.

(n19)Footnote 19. ICTA 1988 s.13 and 13A and FA 2005 s.11(a). *See § 25.15 infra*.

(n20)Footnote 20. ICTA 1988 s.13(7) as amended by FA 2001 s 86(2).

(n21)Footnote 21. ICTA 1988 s.13(2) and FA 2007 s..3(2)(a); the corresponding fraction for year 2006 (CT rate 19%) was 11/400ths and the marginal rate 32.75%; the small companies rate for ring fenced profits of oil and gas companies remains at 19% and the marginal rate at 32.75% - FA 2007 s3(2)(b).

(n22)Footnote 22. ICTA 1988 s.13. "Control" for this purpose is as applied by ICTA 1988 s.416 *See § 25.14[1][a] infra* and *see IRC v. Newfields Developments Ltd. [2001] STC 901* re attribution of the rights held by trustees of two trusts to the widow of a settlor to determine "control" of two companies for purposes of the small companies rate of corporation tax. *See also* Gascoines Group Ltd and others v. Inspector of Taxes ChD [2004 STC 844.

(n23)Footnote 23. ICTA 1988 s.13(4) and *See Revenue and Customs Commrs v Salaried Persons Postal Loans Ltd. ChD [2006] STC 1315.*

(n24)Footnote 24. *(1993) STC 605.*

(n25)Footnote 25. Bachmann v. Belgium [1992] ECR I249.

(n26)Footnote 26. NOTE: The *Bachmann* case is the only one where this justification has been upheld. It has subsequently been narrowed and dismissed in a large number of cases. In *Hoechst* the Advocate General of the European Court of Justice suggested that fiscal cohesion was applicable only where there is tax avoidance in both the host Member State and the Member State of residence.

(n27)Footnote 27. ICTA 1988 Sch.28AA, introduced by Finance Act 1998 Sch.16.

(n28)Footnote 28. ICTA 1988 s.747 *et seq*, as amended by Finance Act 1998 Sch.17.

(n29)Footnote 29. ICTA 1988 s.419. *See § 25.14[2][b] infra*.