Corporation tax

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Introduction

Corporation tax is paid by companies and other bodies on their profits and capital gains (called chargeable gains). Other bodies include clubs and associations. Corporation tax is not paid by partnerships or trusts who pay income tax on any profits.

Corporation tax is an alternative to income tax and capital gains tax. However, there are many provisions of corporation tax that are the same as for income tax.

Companys pay corporation tax on capital gains (which are called chargeable gains) with an exception for residential property where they pay capital gains tax.

Corporation tax is taxed on companys registered in UK or whose main place of business is in the UK. It is also charged on foreign companies with a UK branch or office.

A company is responsible for notifying HMRC of its liability to pay tax, keeping records, filing tax returns (including zero returns), calculating the tax payable and paying tax. Very large companies must appoint a senior accounting officer who personally certifies the tax returns.

The law for corporation tax is largely found in Corporation Tax Act 2009 and Corporation Tax Act 2010. Other provisions can be found in such acts as Taxation (International and Other Provisions) Act 2010, Capital Allowances Act 2001 and Taxes Management Act 1970.

Corporation tax was introduced in 1965, before which companies paid income tax and profits tax.

Basis of charge

Corporation tax is charged for accounting periods. These are usually of one year, apart from in the year that the company starts and ceases, and if there is a change of accounting date. If this spans a change in rate, the period must be apportioned between the periods for each rate.

The tax is charged on the **adjusted profit**. This is the figure shown in the accounts as net profit before tax and dividends. To this various adjustments are made to bring the figure into line with tax law.

The **accounts** must have been prepared in accordance with generally accepted accounting principles. This includes complying with all accounting standards, and producing a true and fair view.

Some of the common changes need to bring net profit to adjusted profit are:

- depreciation is added back and capital allowances deducted,
- disallowed items are added back (see below),
- stock taken for personal use is treated as a sale at normal price,
- any deductions that represent provisions or reserves are added back.

Disallowed items include:

- items for personal use rather than business use,
- entertainment of clients (but not of staff),
- payments of fines, penalties and any crime-related payments,
- capital expenditure (though capital allowances may be claimed).
- dividends paid to shareholders (but interest is deductible when paid to holders of loan notes, debentures, preferential shares and other debt instruments).

From 1 July 2009, all (non-group) dividends are included in taxable profits, regardless of whether they are paid from a UK or non-UK company.

Rates

The rate of tax is determined according to **financial years.** These are periods of 12 months that run from 1 April to the following 31 March. If the company has an accounting period that spans 1 April and the rate has changed, it is necessary to split the accounting period on a pro rata basis and apply the different rates to each part.

Financial years are named according to the calendar year in which they start. So financial year 2018 means the period from 1 April 2018 to 31 March 2019.

Since financial year 2015 there has been one rate of corporation tax. This is 20% for financial years 2015 and 2016, and 19% for financial year 2017. Legislation has been passed to reduce it to 17% in 2020. These are the lowest rates of the G20 countries, making the UK a tax haven for companies.

For periods between 1973 and 2015, there were two rates of corporation tax: a main rate and a **small profits rate** (SPR) which was lower. For years from 1994, the SPR (called small companies rate before 2010) applied to adjusted profit of up to £300,000, and the main rate applied where profits are above £1.5 million. For profits between these limits, profits were taxed at a rate between the two.

For example, in financial year 2012, the main rate was 24% and the small profits rate was 20%. If the company had adjusted profit of £900,000, halfway between the limits, it paid tax at 22%

on all its profits. Another way of looking at this was that the company paid 20% on the first £300,000 and at a marginal rate of 25% on the next £600,000. The marginal rate is the main rate plus one quarter of the difference between the two rates.

The general direction of corporation tax rates has been downward since they peaked at 52% between 1973 and 1982.

Although there is only one rate of corporation tax, there are some special rates that apply in particular circumstances:

- in Northern Ireland there are plans to reduce the rate to 12.5%, the same as in the Republic. This has been enacted as Corporation Tax (Northern Ireland) Act 2015. No date has been set for its introduction
- from 21 October 2015, there is a rate of 45% for restitution interest
- banks pay corporation tax at 8 percentage points above the main rate
- merchant shipping *may* opt out of corporation tax on their shipping activities and pay tonnage tax instead
- oil industry ring-fences its extraction activities which are subject to a higher rate and also some special taxes
- technology companies can reduce their effective rate of tax to 10% using the patent box. There are also generous tax reliefs for research and development.

Accounting periods

Corporation tax is assessed for accounting periods. These are a whole number of days ranging from one day to one year.

A company is free to choose whatever accounting date it wishes. It is usually the last day of the month, but does not have to be. A company may vary that date by up to three days, so a retailer could make the accounts to the last Saturday of December, for example.

An accounting period may not be longer than 12 months. If a company makes up its accounts for a longer period, the first 12 months are one accounting period, and the rest a second accounting period.

A company does not have an accounting period while it is dormant or before it has earned any income.

An accounting period starts:

- when the company first comes within the scope of corporation tax
- when the company first receives any taxable income
- when the company starts trading
- immediately after the end of a previous accounting period
- when a company goes into administration, receivership or liquidation.

An accounting period ends:

- 12 months after the start of the accounting period
- at the chosen accounting date
- when the company becomes, or ceases to be, UK resident
- when the company ceases to be liable to UK corporation tax
- when the company ceases to trade
- just before the company goes into administration, receivership or liquidation
- immediately before winding up commences.

If a company goes into administration or receivership, accounting periods continue every 12 months from that date.

Note that starting to trade starts an accounting period, even if one is already in existence. If a company deposits funds in an interest-earning account ready to start trading, that starts an accounting period. When it does start trading, that starts another accounting period.

Where an accounting period is less than 12 months, any financial limit is pro rata reduced.

HMRC is automatically notified by Companies House of all newly formed companies and will usually write to the company to explain its responsibilities.

Returns

It is the company's responsibility to submit a corporation tax return, regardless of whether HMRC had requested one or reminded the company.

The return is on form CT600, of which versio 3 is used from 1 April 2015. From 2011, his return is now almost always done online. Unlike income tax, there are no exemptions from online filing for religious objection or digital exclusion.

This form may be supplemented by one or more of these forms:

- CT600A loans to participators by close companies
- CT600B controlled foreign companies (and bank levy)
- CT600C group and consortium
- CT600D insurance
- CT600E charities and community amateur sports clubs
- CT600F tonnage tax
- CT600G corporate venturing scheme
- CT600H cross-border royalties
- CT600I supplementary charge in respect of ring fence trades
- CT600J disclosure of tax avoidance schemes

To file a return, the company must be issued with a 16-digit Gateway code. This is requested online but sent by post, so a company should apply well before the first filing deadline.

From 1 April 2014, it is also a requirement that accounts must be submitted where each item is given a code from thge iXBRL taxonomy. For small companies, HMRC provides user-friendly software that simplifies this process. The codes are used for statistical purposes.

A small company also has the option of filing a single document that serves as both the corporation tax return and Companies House return (now called a compliance statement), even though they have different filing dates.

HMRC provides a toolkit to assist in completing the return, highlighting common errors and problems. Completing an online corporation tax return can be a long and tedious process, though HMRC does seem to have simplified the process in recent years.

A return that is not properly submitted is regarded as having not been submitted at all. This means that the company has to resubmit the return. If the company misses the deadline as a consequence, it can be liable to a penalty.

Paper returns had to be signed to indicate by an authorised person to indicate that the tax return is correct to the best the signatory's knowledge and belief. This requirement has been dropped for online returns, where the use of codes serves a similar function to a signature.

HMRC has a period of one year in which it may raise any queries about the return. The company may also amend its return during that year. After that, a return can only be challenged on a **discovery assessment** or where fraud is suspected. The bar is set very low for discovery; a tax inspector changing his or her mind is sufficient. To avoid discovery assessments, the company should consider using the box for additional information, widely known as "white space" to disclose any salient details about the tax return. HMRC cannot "discover" what you explicitly told them at the time.

A company is free to engage in **tax planning,** that is ordering its affairs within the law to minimise its tax liabilities. There is no need to be secretive about doing so. Indeed, tax law contains more than 1,000 provisions designed to assist taxpayers in tax planning. The government is the biggest marketeer of avoidance schemes. However, a company should not engage in artificial or contrived schemes which are likely to be defeated by anti-avoidance laws and are clearly contrary to the intention of the law. Such schemes are routinely defeated in the courts and tribunals, often incurring penalties for those who use or promote them.

It should be appreciated that corporation tax is itself widely used for tax planning. It is a means by which a trader can pay tax at 19% instead of income tax at rates up to 45% (46% in Scotland) possibly plus national insurance. There are various ways by which an owner-manager may **extract profits.** This can be done when the owner has retired, and is paying lower rates of income tax and not paying national insurance at all.

Profits can be extracted as salary, dividends, rent, loans, pension or in other ways. An effective way is often to extract salary at an amount equal to the earnings threshold for class 1 national insurance and the balance as dividends. That is a good starting point, though each case must be considered according to its own circumstances.

Due dates

Corporation tax must be paid within 9 months and 1 day of the accounting period. The corporation tax return must be submitted within 12 months of the end of the accounting period. For an accounting period that ends on 31 March 2018, corporation tax must be paid by 1 January 2019 and the return submitted by 31 March 2019.

If HMRC sends a company a notice to file, the return must be submitted by the later of 12 months after the accounting period end and 3 months from the date of the notice.

It should be noted that the deadline is interpreted strictly. Nine months and one day after 28 February is 29 November, not 1 December.

If a company has taxable profits above £1.5 million, it must pay corporation tax in instalments.

Profit calculation

Corporation tax is charged on **adjusted profit.** This is net profit before tax and dividends, per the accounts, which is then adjusted in accordance with tax law.

A company must keep accounts under Companies Act 2006 ss386-387. It must keep adequate accounts for tax purposes under Finance Act 1998 Sch 18 para 21(5).

Traditionally, accounts could be kept in almost any form, including handwritten notes in an exercise book. From 2020, a programme known as **Making Tax Digital** requires accounts to be kept on a computer with online access to HMRC.

It is necessary to distinguish different sources of income as these can be subject to different rules. For example, more expenses are allowed against trading income than for investment income.

A company may have income from one or more of these sources:

- trading income
- property income
- investment income
- income from intangible fixed assets
- loan relationships
- chargeable gains
- sundry income.

By far, the commonest source is trading income.

Originally there sources were identified as schedules, where Schedule A was property income and Schedule D was trading income. The schedules were discontinued in 2010 when sources were described rather than categorised. Principles from the schedular system are still evident.

Sometimes the distinction is not always clear. A trader who lets out some surplus space, such as in a shop or warehouse, may usually treat the income as trading income, rather than property income.

The distinction can become marginal when letting property. If additional services are provided, such as in a hotel or guest house, the income is trading rather than property. There have been cases on exactly what services must be provided to qualify as a trade.

Foreign income is now usually taxed on the same basis as UK income, though there are still some differences, particularly for loss relief.

Pro-forma corporation tax computation

The following pro-forma sets out the basic structure for a corporation tax computation.

Corporation Tax computation for .... months to ....

		£
	£	
Trading Income		
	Adjusted profits	X
	Less: capital allowances	(X)
	Trading Income	X
Property Income		
	Profits of a UK property business	X
	Profits of an overseas property business	X
		X
Profits on non-trading loan relationships		X
Miscellaneous Income (e.g. profits on non-trading intangible fixed assets)		X
Net chargeable gains		X

Less:	Qualifying charitable donations	(X)
Total taxable profits		X

Figures with brackets round them are subtracted.

There are other reliefs and adjustments that can affect the amount of corporation tax payable, though many of these will not be encountered in practice.

A full procedure in four steps is given in this extract from Finance Act 1988 Sch 18 para 8:

Step 1 is to calculate the corporation tax by applying the main rate or small profits rate to total taxable profits.

Step 2 is to subtract from the above figure:
- marginal relief (under Corporation Tax Act 2010 ss19-21)
- corporate venturing scheme (CVS) relief (under Finance Act 2000 Sch 15)
- community investment tax relief (CITR) (under Corporation Tax Act 2010 Part 7)
- double taxation relief (Taxation (International and Other Provisions) Act 2010 ss 2, 6, 18)
- advance corporation tax (under Income and Corporation Taxes Act 1988 s239 or Finance Act 1998 s32).

Step 3 is to add to the figure from step 2:
- tax payable on close company loans to participators (under Corporation Tax Act 2010 ss455, 464A)
- supplementary charges for ring-fence trades (under Corporation Tax Act 2010 s330)
- sums charged in respect of controlled foreign companies (under Taxation (International and Other Provisions) Act 2010 Part 9A)
- bank levy (Finance Act 2011 Sch 19)

Step 4 is to deduct from the figure from step 3 (on all amounts before bank levy):
- income tax suffered by deduction at source (Corporation Tax Act 2010 ss 967-968)
- advance corporation tax on foreign income dividend (under Income and Corporation Taxes Act 1988 ss 246N, 246Q).

Payment

A company may pay its tax in one of several ways, including direct debit and online banking, which is now the most common form. If payment is made by **Faster Payment Service**¸ which HMRC has accepted since 2011, the payment is regarded as having been made on the date it was received in HMRC's bank account, even if that is not a working day. If payment is made by other means, such as posting a cheque, sufficient time must be allowed for the cheque to be

received *and cleared* by the due date or, if that is a weekend or bank holiday, by the last working day before the due date.

Payment may be made by debit card or by a company credit card. Payments can no longer be made using a personal credit card or (from 15 December 2017) through the Post Office. Payment may also be made using CHAPS, BACS or a bank giro.

Companies with adjusted profit of less than £1.5 million pay corporation tax in one payment, by nine months and 1 day after the end of the accounting period.

Companies with adjusted profit of £1.5 million or more must generally pay some of the tax earlier in instalments. There are exceptions for companies with profit above £1.5 million if either:

- the total tax liability for the accounting period is less than £10,000, or
- the adjusted profit is less than £10 million AND either the company did not exist or have an accounting period in the previous 12 months, or its tax liability for such accounting period did not exceed £10,000.

The figures of £10,000, £1.5 million and £10 million are reduced if the company has associated companies.

The payment dates for **instalments** are changing. The current rule (from 1 July 2002) is that the first instalment is due 6 months and 13 days after the first day of the accounting period. The second, third and fourth instalments are due 3, 6 and 9 months later.

If a company uses the calendar year as its accounting period, the due dates for the accounting period from 1 January 2018 are:

- 14 July 2018
- 14 October 2018
- 14 January 2019
- 14 April 2019.

Any balance is payble 9 months and 1 day after the end of the accounting period, that is 1 October 2019.

The first two instalment dates are before the accounting period has finished, and the third is only 14 days after it has ended. This means that a company must pay some of its corporation tax before it knows what it is. This is calculated according to an estimate of corporation tax liability, largely based on the previous year's accounts.

As the year progresses, the company will often get a more accurate idea of the likely corporation tax. For each instalment, the amount is revised with latest expectation. A company may make additional top-up payments at any time.

For an accounting period up to 3 months, a single payment of tax is made with no instalments. For accounting periods of between 3 and 12 months, each instalment is the estimated tax for the period divided by n/3, where n is the number of months in the accounting period.

Inevitably, instalments will prove to be more or less than the actual figure. In a group of companies, an overpayment for one company may be offset against an underpayment for another.

When the corporation tax return is submitted, HMRC calculates how much the instalments were overpaid or underpaid. Interest is charged on underpayment, and interest at a lower rate is paid for underpayments. From 13 November 2017, the interest rate on underpayments is 1.5%; the rate for overpayments is 0.5%. If a company deliberately underestimates the amount of an instalment, a penalty may be imposed.

If the first month of a 12-month accounting period is numbered 1, instalments are due in months 7, 10, 13 and 16, with a final balancing payment in month 21.

It has been announced that from 1 April 2019 (postponed from 1 April 2017) companies with profits above £20 million will pay instalments in months 3, 6, 9 and 12, with the balancing payment in month 21.

If a company has a cashflow problem, it may ask for a **Time to Pay** (TTP) arrangement by calling 0300 200 3835. This allows a taxpayer a little longer to pay tax without incurring interest or penalties. TTP was introduced in December 2008. From 3 August 2015, a TTP usually requires a direct debit to be set up. TTP applies to all taxpayers and to all taxes.

Corporation tax works on a “pay now, check later” principle. A company should not assume that a tax return is final because it has been accepted by HMRC.

Accounting records should be kept for the current year and the previous six years. They may be kept on a computer file. Records should include not just accounting records, but correspondence, tax returns and price lists.

Particular types of company

Some companies have special corporation tax provisions.

A **close company** is one with five or fewer participators or where all the participators are directors. A participator usually means a shareholder.

The main provision for a close company is that a loan or advance to a participator triggers a tax liability of 32.5%.

Husband and wife companies are where one partner sets up a company and gives shares (often half the company) to the other partner. This is an effective way of utilising both partners' personal allowances and lower rate bandwidths for income tax. In the notorious case *Jones v Garnett [2005],* HMRC argued that the husband had created a trust for his wife. This argument was eventually rejected by the House of Lords.

Credit unions are exempt from tax.

Personal service companies (PSCs) are when an individual provides him or her services through a limited company they control in circumstances where they would otherwise be classed as an employee. This is commonly known as IR 35 from the number of the press release that announced it. The PSC must operate PAYE payroll for the worker. From 6 April 2017, where a PSC provides services to a public sector body, such as an NHS hospital, that body must deduct tax and national insurance and pay it to HMRC.

Loss relief

If a company makes a loss for an accounting period, it must still file a return, showing profit as nil.

The loss can be offset in up to five ways, two of which were significantly revised from 1 April 2017:

- carry forward
- carry back
- terminal loss relief
- sideways loss relief
- group relief.

Carry forward means the loss may be carried forward indefinitely against the profits from the same trade. This loss relief is the default position. This is how HMRC will give loss relief unless the company specifically asks for another method.

The right to carry forward stops if there is a change in ownership and a major change in the nature or conduct of the trade.

From 1 April 2017, carry forward losses are restricted to 50% of current year profits subject to a £5 million allowance.

Carry back allows a loss to be offset against the profit of the *previous* year (even if this is more than one accounting period). As the tax will usually have been paid for the previous year, this will usually result in a repayment of tax.

Terminal loss relief allows losses in the last 12 months of a trade to be offset against profits in the *three* previous years.

Sideways loss relief allows a trading loss to be offset against other profits in the same accounting period and (from 1 April 2017) for future accounting periods.

Group relief allows a loss by one member of a group of companies to be offset against the profits of another group company.

A capital loss (opposite to chargeable gain) may only be offset against a chargeable gain, not against profits. This is subject to two limited exceptions for investment businesses.

Chargeable gains

Chargeable gains are capital gains made by a body subject to corporation tax. Note that some assets, such as plant and machinery, are not subject to chargeable gains corporation tax.

The gain is disposal proceeds minus acquisition cost, subject to indexation.

Normally, only the gain that has accrued since April 1982 is taxed. If the asset had a higher value before April 1982, that value may be used for acquisition cost.

If the asset was acquired before 6 April 1965 (when corporation tax was introduced), the value as at 6 April 1965 may be used with a time apportioned exclusion for ownership before 1965.

Indexation allows the acquisition to be uplifted, thus reducing the amount of chargeable gain. This is designed to prevent the charge being a tax on inflation.

The index is the retail prices index, not the consumer prices index now generally used to measure inflation. Indexation may be used for any period up to December 2017. If an asset is disposed of from January 2018, it uses the index for December 2017.

For example, a company buys premises for £1 million in January 1989 (index = 111.0), and sells it for £5 million in January 2018 (index for December 2017 = 278.1)

The acquision cost is uplifted by 278.1/111.0 to £2,505,405.

The indexed chargeable gain is therefore:

disposal proceeds:	£5,000,000
indexed acquisition cost:	£2,505,405
chargeable gain	£2,494,595

In this example, indexation has more than halved the chargeable gain.

An alternative approach is to use indexation factors produced by HMRC for each month.

A chargeable gain may be subject to **rollover relief** or **holdover relief.** Although called reliefs, these are both postponements of tax rather than relief. Rollover relief allows a chargeable gain from, for example, the sale of a property to be applied to a new property without triggering a tax charge. Instead the life of both assets is treated as if they were one. Proceeds can be repeatedly rolled over in this manner, with no tax payable until the last one is disposed of. **Holdover relief** allows two periods of ownership to be treated as one, subject to conditions.

Associated companies

Two companies are associated if either one owns the other, or they are both owned by the same company or individuals or an individual's close relation. For a group of individuals, it is necessary to consider the "minimum controlling combination".

For accounting periods that end on or after 1 April 2015, companies are associated if one owns 51% of the other or both are 51% owned by a third person (or company).

Where two close relations each own a business, from 1 April 2011, they are only considered associated if there is some interdependence between them. This ended the anomaly that two company owners paid more tax when married than if they remained single, even if the two companies had no connection.

Where two or more companies are associated, various thresholds are divided by the number of companies.

So if three companies are associated, the £300,000 and £1.5 million thresholds for corporation tax rates become £100,000 and £500,000 for each company.

This provision has become of less relevance since 2015 from when there is only one rate of corporation tax. It is still relevant for other provisions such as whether the company must pay corporation tax in instalments.

Groups

A company and its subsidiaries may form a **group** for the purposes of corporation tax.

The concept of a group for corporation tax is different from that for accounting and for VAT. For corporation tax purposes, a group comprises a parent company and those subsidiaries where it holds at least 75% of the shares, or where both companies are 75% controlled by the same person. (A different rule applies for chargeable gains.)

(For accounting, a group comprises a parent company and its subsidiaries where the parent holds more than half the shares. For VAT, the group can choose which companies to include.)

The consequences of being in a group are:

- trade between group members is removed from the accounts
- sums owed to each other are removed
- dividends can be paid to another group member without deduction of tax
- assets can be moved between members without tax consequences.

Corporation tax is not charged on groups but on each separate company. This can be mitigated by **group relief** which allows a loss from one company to be offset against the profits of another.

A company may claim **substantial shareholding exemption** if it disposes of shares in a company where it has held at least 10% of the share capital for 12 months.

There are many anti-avoidance provisions to prevent groups being used for artificial tax avoidance. These provisions include transfer pricing.

It is also possible for a company to be owned in a **consortium.**

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