Corporation tax

Corporation tax is the tax paid by companies on their profits. Unincorporated organisations (such as clubs and societies) also pay corporation tax, if they have taxable income. Partners in both traditional and limited liability partnerships and sole traders pay income tax instead.

If you use accountants to prepare your year-end figures, or auditors to check them, they may calculate your corporation tax liability, too. But you cannot afford to ignore corporation tax until the year end, because your activities during the year could have a significant impact on the final bill.

This briefing explains:

- How corporation tax is calculated.
- When you have to pay it.
- When you can offset losses.
- How to minimise your tax bill.

1 Calculating taxable profits

Tax is levied on all the profits made during an accounting period.

1.1 Profits can arise from several **sources**. They have to be calculated separately and totalled at the end.

- Trading profits — income from your company's trading activities, less allowable expenses.
  For example, if you run a manufacturing or service company, you will have to pay tax on the profits made from selling the goods or services, after allowing for labour, raw material costs, etc.
- Capital gains — the profits made from selling certain company assets.
  For example, if you make a profit from selling a factory, it will be taxable unless you reinvest the money (see **5.3**).
- Income from letting out land or buildings.
- Interest on any money held on deposit.
  Unlike individuals, companies generally receive interest without tax having been deducted.
- Most other forms of income or capital gain.
  For example, any profits made on currency movements.

  Profits from different sources have to be calculated separately, because different rules apply to income and expenditure on each.

  The rules are complex. Ask your accountant, tax adviser or auditor for advice.

Directors' Briefing

a book in four pages

More than 160 briefings are now available.

If you need further information or help, ask the distributor of this briefing about the services available to you.

1.2 Companies are taxed on the profits made in an **accounting period** — normally their financial year.

- The end of an accounting period can also be triggered by the company going into liquidation or ceasing to trade.
- Tax rates are set for the tax year, which (for corporation tax purposes) runs from 1 April to 31 March.
- Where the company's accounting period and the tax year do not coincide, the profits must be time-apportioned to decide which rate should apply.

1.3 The **geographical basis** for the tax charge depends on where the company is resident for tax purposes.

- Companies resident in the UK pay corporation tax on their worldwide profits.
- Companies resident elsewhere normally pay corporation tax only on their profits from a UK branch or agency.
  Non-UK profits are generally taxed (often at higher rates) elsewhere.

  Check your situation with your accountant or tax adviser.

2 How much tax?

The rate at which tax is paid depends on the level of the company's profits, with lower profits taxed at a lower rate. But there are provisions to prevent companies from splitting themselves up to reduce tax charges (see **2.2**).

2.1 There are **two corporation tax bands** in the tax year 2008/09:

profit (£)	tax rate
0–300,000	21%
Over 1,500,000	28%

If your profits fall between £300,000 and £1.5 million, you are eligible for marginal relief. This is designed to ease the transition from one rate to the next. The limits are reduced for companies belonging to groups.

The small companies' rate will be increased to 22 per cent in 2009/10.

2.2 Where there are **several companies** under common control the above limits will be split between them, unless it can be proved that they are not carrying on a trade or business.

3 Payment

Companies are responsible for assessing their own liability to corporation tax and for ensuring that all the money which is due is paid on time.

3.1 **Most companies** have to pay corporation tax within nine months and one day of the end of their accounting period.

- This rule applies to small and medium-sized companies (ie those with profits of up to £1.5 million).
- Tax must be paid in full at the due date, whether or not HM Revenue & Customs (HMRC) is challenging the figures shown on the return (see **3.3**).
- Interest is charged on late payments.

3.2 **Larger companies** have to pay the tax due in quarterly instalments.

- The first instalment has to be paid six months and 14 days after the end of the preceding accounting period (ie halfway through the accounting period to which the payments relate).
- Two further quarterly payments then have to be made with the balance payable within three months and 14 days of the end of the accounting period.

  Special rules apply where the accounting period is not 12 months.

3.3 All companies have to notify HMRC of their profits by submitting their **corporation tax return**.

- The corporation tax return must be made within 12 months of the end of the accounting period.
  There are penalties for failing to file on time.
- If HMRC disputes any of the figures shown on the corporation tax return, the company may face an enquiry or a demand for extra tax. The Inspector normally has 12 months from the filing deadline to make enquiries into a return.

4 Losses

Losses can sometimes be used to reduce the corporation tax bill. However, their use is subject to strict rules, to prevent tax evasion.

4.1 **Trading losses** can be offset against any other profits (including capital gains) made in the same accounting period.

- They can also be carried back against

profits made in the preceding accounting period.
- Alternatively, they can be carried forward and set off against future profits from the same trade.
- But they cannot be carried forward if the company changes hands and there is a major change in the business.
  So there is no point in buying or selling companies purely for the sake of their tax losses.

4.2 It may be possible for other companies **within the same group** to make use of a company's trading losses.

- To qualify, at least 75 per cent of the shares must be owned by the parent company.
- There are other restrictions. For example, when a company joins or leaves the group.

4.3 **Capital losses** can only be offset against capital gains.

They cannot be offset against trading income.

- However, they can be carried forward indefinitely, so they should always be recorded, even if they cannot be used immediately.

Take the example of a company which makes a loss of £20,000 on the sale of an asset in one year, cannot use the loss for three years, but then makes a profit of £30,000 on the sale of a lease.

The capital loss can be offset against the later gain to reduce it to £10,000 for tax purposes.

The company bank account

Owner-managers should avoid using the company bank account as a second personal account.

Every payment must be accounted for.

- If cash payments to owner-managers cannot be identified as salary or dividends, they will be treated as loans from the company.
- Such loans can have serious tax consequences.
  To avoid these, it is generally necessary to repay the loan within nine months of the year end.
- Use of the company's bank account for personal expenditure also creates extra work for the company's accountants, and may lead to increased fees.

5 Minimising the tax bill

Increasing profits is generally more important than avoiding tax. However, you may be able to reduce unnecessary tax payments.

5.1 Limit the number of your **subsidiary or associate companies**.

This is because the top limit on the tax band applying to each subsidiary will be split according to the number of companies within a group.

- Profits above that limit will be taxed at the marginal rate applying to the next band. So the existence of small companies within a group could have a serious impact on the amount of tax paid.
- If you must set up subsidiary or associate companies, try to spread profits evenly between them.
  It may be possible to use inter-company management fees to do this, although HMRC could disallow them if there is not a legitimate business reason for the service.

5.2 Consider using **loans**, rather than shares, to finance the company.

- Interest on loans is an allowable expense against profits, whereas dividends on shares are not.

5.3 Ask your professional advisers about the standard methods of **reducing profits** without damaging the company or its prospects.

- Take advantage of capital allowances and the Annual Investment Allowance available on equipment purchases.
- If possible, reinvest the proceeds of any asset sale and use 'rollover relief' to reduce capital gains.

5.4 Consider using **benefits in kind**, rather than extra salary, as a mechanism for taking money out of the company.

- Employers have to pay National Insurance (NI) on almost all benefits in kind.
  But employees do not pay NI on most benefits.
- Income tax has to be paid on such benefits, but they qualify as earnings when you calculate how much you can pay into a personal pension scheme.

➨ To find a local chartered tax adviser, contact the Chartered Institute of Taxation on 020 7235 9381.

- It is important that the company purchases the benefit (eg medical insurance), rather than reimbursing you.

5.5 Consider using **dividends**, rather than a higher salary, to take money out of the company.

- All profits paid as dividends to a shareholder which is not a company are taxed at a minimum of 20 per cent. The zero rate remains if profits are re-invested in the business.
- But, in a company with profits up to £300,000, dividends might still be more tax efficient than pay.
  They are exempt from NI, and for basic rate taxpayers there is no income tax to pay.
- Higher rate taxpayers would have to pay more income tax, but not immediately as with earnings.
- You may need advice on how to structure any dividend payments.
- Payment by dividend may limit the amount you can contribute to an approved pension scheme, as the amounts do not count as earnings.
- Payment by dividend may also limit your rights to state benefits.

This sort of planning may not be effective if yours is a personal service company and you work under the control and management of any of your clients.

In such cases you may be caught by the IR35 rules and be deemed to receive a salary larger than the one you actually draw. If you run such a company, seek professional help.

6 Where to get help

6.1 HMRC assumes that you will employ a properly qualified accountant or tax adviser to help you with corporation tax.

- Appoint an adviser to deal with correspondence with HMRC (see **6.2**).
- HMRC will send you the appropriate forms as soon as a company has been registered with Companies House.
- Your local tax office can assist with minor problems.

6.2 Most firms of **accountants** can provide you with advice on corporation tax.

- The service and expertise offered by accountants varies greatly. The fees charged vary accordingly.
  Shop around for the right level of advice at the right price level for your circumstances.
- Accountants should be members of the Institute of Chartered Accountants (signified by the initials ACA or FCA) or the Association of Chartered Certified Accountants (ACCA or FCCA) or the Chartered Institute of Management Accountants (signified by the initials FCMA or ACMA).

6.3 Chartered Tax Advisers who are members of the Chartered Institute of Taxation (CTA, ATII or FTII) can advise you on your tax affairs and calculate your tax liability.

- Contact the Chartered Institute of Taxation for more information (020 7235 9381 or www.tax.org.uk).

6.4 Solicitors can advise you on the legal aspects of corporation tax.

© BHP Information Solutions Ltd 2008. ISSN 1369-1996. All rights reserved. No part of this publication may be reproduced or transmitted without the written permission of the publisher. This publication is for general guidance only. The publisher, expert contributors and distributor disclaim all liability for any errors or omissions. Consult your local business support organisation or your professional adviser for help and advice.

Published by BHP Information Solutions Ltd, Althorp House, 4-6 Althorp Road, London SW17 7ED
Tel: 020 8672 6844, www.bhpinfosolutions.co.uk