

CORPORATION TAX LIABILITY

Basis of Tax Computation

UK resident companies are taxed a Corporation Tax on their income and chargeable gains arising in an "accounting period". This will usually be the 12 month period of the financial accounts. However, the applicable accounting period is subject to special rules set out below, as is the case in Ireland. This may mean that the assessment is made on a basis different to the actual accounts period. It may be necessary to apportion profits between different accounting periods.

A period of account must usually be a 12 month period. An accounting period starts when the company starts to trade or commences a new trade or when a previous accounting period ends. A previous accounting period ends on the earliest of 12 months after the beginning of the period, the end of the company's actual period of account or the date the company begins to cease to trade. If accounts are prepared for a period longer than 12 years they are apportioned and divided into two periods.

UK resident companies are subject to UK Corporation Tax on all their profits and capital gains worldwide. A company is deemed to be resident in the UK if it is incorporated in the UK or if it is incorporated elsewhere if it is centrally managed and controlled in the UK. A company is centrally managed and controlled where the key major policy decisions are made. A UK incorporated company (i.e. formed under the UK Companies Acts and registered with Companies House, Cardiff) is always deemed resident in the UK for Corporation Tax

Calculation of Corporation Tax

A company's Corporation Tax liability for an accounting period is calculated by computing profits from all sources and deducting charges on income. In computing tax

profits subject to Corporation Tax, trading profits and various sources of income such as trading profits, interest, dividends, property tax and chargeable gains are added together. This is "total profit". From this sum charges on income are deducted to leave Corporation Tax.

Trading income and expenditure is computed much as sole traders profits and losses. See our notes on the way this is calculated.

Dividends received from UK companies are effectively exempt from Corporation Tax (as is the case in Ireland). Dividends from overseas companies are subject to Corporation Tax.

A company's capital gains and losses are computed in accordance with the general capital gains tax principles. As in Ireland companies pay Corporation Tax on capital gains which has certain knock on consequences, particularly in relation to losses.

The rate of Corporation Tax is fixed for financial years. Financial year runs from 1st April to 31st March. There may be two rates applied on an apportioned basis to the Company's accounts period, if there has been a tax rate change in the year.

There is a special lower level of Corporation Tax payable at small companies rates if profits are below £300,000. If profits exceed £1,500,000 the company is deemed large and subject to Corporation Tax at 28%. Where profits are between £300,000 and £1,500,000 a special marginal relief is paid so that the profits are taxed at rates between 19% and 28%.

In determining the rate of Corporation Tax it is necessary to add on dividends received from UK companies although they are not specifically taxable i.e. they may affect the rate that applies.

Where an accounting period is less than 12 months at the above limits are apportioned.

Losses

Tax adjusted trading losses are computed in the same way as tax adjusted profits. Adjusted profits or losses are reduced by capital allowances. Where a company makes a trading loss a nil amount is entered in its computation tax return for the period.

A loss can be relieved in three ways. It can be carried forward and set off against the first available future profits of the trade. It can be offset against the current period total profits including all income source (before charges on income) or it can be offset against total profits of the current period and then relieved against total profits of the previous 12 months (before charges). If a company ceases to trade permanent a further "terminal" loss relief can be claimed.

Losses are automatically carried forward against the same trade unless a claim is made to have them treated otherwise. The loss can be carried forward indefinitely against future profits until fully used or cancelled. This applies only to the profits of the same trade. Losses must be set against the first available trading profits. If a company changes its trade any remaining unrelieved losses are lost for the purpose of set off against tax.

The claim to offset losses against total profits (before charges) in the same accounting period must be specifically claimed. The claim must be for the whole loss. It is not possible to restrict the amount of the loss claimed. The amount of the loss may be reduced by not claiming the full amount of capital allowances available. A claim for the relief must be made within 2 years at the end of the loss making accounting period.

It is also possible to set back losses one year against total profits before charges. This claim can only be made if a claim for current year loss relief has been made first. The claim must be made within two years of the end of the loss making accounting period.

Where a company incurs a trading loss during its final 12 months of trading it is possible to carry that loss back against total profits for up to 3 years preceding the loss making period. This is called "terminal relief".

Tactical considerations arise in choosing which loss relief to claim. Timing of tax saving cash flow implications arise. The aim should be to set losses against income taxed at the highest possible tax rates. Carry back of losses against the prior year profit may result in immediate cash repayment which is positive for cash flow.

In the case of property business losses, (i.e. rental losses), they are set first against income and gains for the current period and the excess is carried forward and offset against future income gains of the company. There is no carry back for property business losses.

Capital losses are offset against gains arising in the same period. The excess losses can be carried forward against gains in future accounting periods. A capital loss can never be carried back and capital losses can not be set off against company's income.

Ascertaining Taxable Trading Profits

Companies pay Corporation Tax for an accounting period on the profits and other income chargeable to Corporation Tax.

Trading profits are computed in the same way as a sole trader's trading profits. The accounts as profits and loss accounts are adjusted by disallowing expenditure not allowed and allowing other expenditure specifically allowed

Capital expenditure, gifts, depreciation, profits arising on disposal of capital items and non trading income are removed from the financial accounts.. There are some minor differences on the way the adjustments are made but they are broadly similar to that as set out above in relation to adjusting a trader's profit.

Interest payable in relation to trading activities is allowed as a deduction against trading profits. Interest in relation to non trading activities must be added back. Dividends payable by the company are not allowed as a trading expense. They are an appropriation of profit to the shareholders.

The rules in relation to capital allowances and industrial building allowances are broadly the same as for sole traders. See our note on capital allowances.

Where accounting periods are shorter than 12 months the allowances are reduced proportionately. First year allowances are always allowed and are never reduced even in a short accounting period.

Interest paid and payable on borrowings for trading purposes is deductible as an expense. Interest payable on borrowings for non trading purposes is added back but maybe allowed otherwise. Trading purposes would include interest on loan to purchase plant and equipment, to fund an overdraft. Interest payable on a loan to acquire shares in another company is not allowed as a trading interest.

Where a company holds properties it is subject to the same rules in relation to property investment as for individuals. Interest payable on a loan to acquire or improve an investment property is not allowable as a deduction from property business income but may be otherwise allowed.

Losses from the property business are pooled to obtain an overall property business profit or loss. Property business loss is set out against total profits for the same accounting period and then the same carried against total profits in the future. Property business loss is also available for group relief.

Most Company income is taxable in much the same manner as for an individual. Dividends received from UK companies are usually not taxed.

This Guide is intended as an overview and broad outline of the matters covered in it. Its purpose is to inform and raise awareness. We are happy to offer specific legal advice on particular circumstances.

This Guide should not be relied on as a substitute for comprehensive legal advice with reference to the particular circumstances.

While we have taken due care in the preparation of this publication, we do not accept legal liability as a result of any reliance placed on anything in this Guide. The reader should rely only on specific legal or taxation advice.