UNITED KINGDOM

CORPORATE TAXATION

Introduction

Companies are subject to corporation tax, which is levied on corporate profits and other forms of income, as well as on chargeable gains accruing to companies. The tax is an annual tax, imposed by the yearly Finance Act.

Employers pay national insurance (social security) contributions on salaries. A VAT system applies. An additional petroleum revenue tax applies for companies engaged in the exploration for and exploitation of petroleum. There is a special beneficial regime for shipping.

For tax purposes in general, the United Kingdom comprises Great Britain and Northern Ireland, i.e. England, Wales, Scotland and the six counties in the north-east of the island of Ireland. It also includes the United Kingdom's continental shelf. Gibraltar, Guernsey, the Isle of Man and Jersey do not form part of the United Kingdom for tax purposes. They are dealt with in separate chapters.

The currency is the pound sterling (GBP).

1. Corporate Income Tax

1.1. *Type of tax system*

1.1.1. The ACT system up to 5 April 1999

The UK Advance Corporation Tax (ACT) regime, which was in force until 5 April 1999, was a method of securing payment of corporation tax imputed to shareholders receiving dividends. Under the regime, a company making a qualifying distribution was required to pay ACT at a fraction linked to the lower rate of income tax. Qualifying distributions were, broadly speaking, any distribution made by a company, except for the issuing of redeemable share capital or bonus securities or bonus redeemable share capital. The ACT paid was creditable against the mainstream corporation tax (i.e. the actual payment of tax) when that was due. It could therefore not be regarded as a withholding tax on the distribution, but rather as a prepayment of corporation tax.

The amount of ACT which could be set off against the mainstream corporation tax was restricted if the company had made the maximum distribution out of the profits for that year. This would lead to some companies accumulating surplus ACT, which could be carried forward, and to a certain extent carried back or surrendered to other companies in a group. The existing surplus ACT led to a regime of shadow ACT being kept after 6 April 1999, in order to regulate the setting off of the surplus.

1.1.2. Partial imputation system after 6 April 1999

Advance corporation tax (ACT) was abolished with effect from 6 April 1999, but notwithstanding its abolition, the corresponding imputation credit attaching to a dividend remains intact, albeit at the rate of 1/9 and non-repayable.

Under this regime, a distribution will give the following gross receipt to the shareholder:

Year to 31 March	
corporate profits	1,500,000
corporation tax at 28%	(420,000)
dividend paid	1,080,000
1/9 imputation credit	120,000
gross receipt	1,200,000

For an example of the tax liability of an individual shareholder, see Individual Taxation, 1.5.

Dividends derived by resident companies from other resident companies continue to be exempt from corporation tax. Thus, there is no economic double taxation if dividends are paid among resident companies. Income in the form of dividends in the hands of resident companies is called franked investment income.

Rules exist to deal with unrelieved surplus ACT (see 1.1.1.) as at 6 April 1999. These rules, which are commonly referred to as shadow ACT, allow unrelieved surplus ACT to be carried forward to be set off against corporation tax for tax years after 6 April 1999. Such surplus ACT would otherwise have been lost because of the abolition of the ACT system. For each year, the maximum set-off of surplus ACT against corporation tax is 20% of taxable profits of the year less shadow ACT equal to 20/80 of the dividend payment of the year.

1.2. *Taxable persons*

Companies incorporated under the Companies Act are taxable persons for corporation tax purposes. In addition, persons liable to corporation tax include unincorporated associations, building societies (housing loan financing associations), mutual insurance societies, state-owned industries, public utility companies, crown corporations and permanent establishments of non-resident companies.

Charities are generally exempt from the charge to corporation tax, unless they are trading and their trading is not exercised in the course of carrying out the primary purpose of the charity, or is carried on mainly by its beneficiaries.

This survey is restricted to UK-incorporated public and private limited companies, as well as to foreign-incorporated entities of a similar description, whether or not they are resident in the United Kingdom. These entities are referred to in the text as companies.

Partnerships are transparent for tax purposes.

1.2.1. Residence

Companies incorporated in the United Kingdom are always resident there. Other companies are resident if the central management and control takes place in the United Kingdom. The decisive factor is the place where the board of directors meets or where the company's policy decisions are made, rather than the day-to-day management. The tax authority, HM Revenue & Customs (HMRC), takes a substantive view of central management and control, tending to look at the de facto direction of the company, and where it is located.

If a company is resident in the United Kingdom under domestic law but is regarded as resident in another country for the purposes of a tax treaty, it is regarded as not resident in the United Kingdom.

1.3. *Taxable income*

1.3.1. General

Resident companies are chargeable to corporation tax on their worldwide profits, defined as income and chargeable gains.

The computation of annual profits and losses is based on commercial accounts. In general, income and expenses are accounted for on the accruals basis.

Trading income is generally accounted for at the value received. There are some exceptions to this principle, whereby the actual receipt may be substituted by the market value. These include:
- transfer pricing rules for transactions between companies under common control;
- the *Sharkey and Wernher* principle, whereby the market value is entered on the transfer of trading stock from one of the taxpayer's trades to another, or from a trade to private use; and
- the appropriation of assets to trading stock.

If there are reasons other than the trade for payments made, they may not be chargeable, or if chargeable, then only as gains.

1.3.2. Exempt income

The only important item of exempt income is dividends received from resident companies (see 2.2.).

1.3.3. Deductions

1.3.3.1. Deductible expenses

In general, in order to arrive at the taxable trading profits, expenses are deductible, provided that they are of a revenue nature and that they are wholly and exclusively laid out or expended for the purposes of the trade. Also, they must not be disallowed by statute.

Dividends are not deductible, whereas interest and royalties generally are. However, certain payments of interest and royalties may be classified as dividends for tax purposes.

Interest is treated as trading expenditure where it is paid in respect of a loan taken up for trading purposes. Otherwise, a net deficit of interest receipts and payments is deductible as a non-trading item from the total profits of the company. The same applies to management expenses if they are not incurred in a trade, e.g. those of an investment company.

Some costs are deductible as annual charges, which means they are not treated as expenditure in computing the profit or loss of a trade, but instead the gross amount of the payment is a deduction from the company's total profits, including chargeable gains. Annual charges comprise the payment of patent royalties, obligations under a deed of covenant and annuities.

Pre-trading expenditure incurred and annual charges paid in the 7 years before the commencement of trading are deductible on the commencement of trading.

A separate regime applies to the taxation of intellectual property, goodwill and other intangible assets created or acquired from unrelated parties after 31 March 2002. The cost of such assets is treated as deductible expenditure in accordance with current accounting principles. Disposals give rise to income on the same basis. All such items are aggregated and brought into account as trading or non-trading debits and credits.

1.3.3.2. Non-deductible expenses

There are special provisions disallowing the deduction of expenses for business gifts and business entertainment, although such expenses may be deducted when they are made in respect of employees. Exceptions apply for certain small gifts.

No deductions are allowed in respect of capital expenditure, except for capital allowances (see 1.3.5.).

1.3.4. Valuation of inventory

The extent to which assets are trading stock (inventory) depends on the nature of each particular trade. The value of trading stock at the end of the year must be entered as a receipt in the accounts and as an expense in the beginning of the next year. It is valued, on a consistent basis year by year, at the lower of cost or market value and in accordance with generally accepted accountancy principles, which means losses may be anticipated, but not profits. In general, only the FIFO method is accepted for tax purposes.

The cost is equal to acquisition cost, including repairs. Maintenance costs are disregarded (treated as an immediate expenditure). The market value is the net realizable value, not the replacement value. It is the normal retail price which is used, and stock may not be written down below this.

Work in progress must be included in the end of year valuation. The cost is assessed by reference to the direct

allocation method (although overheads may be included).

1.3.5. Depreciation and amortization

In general, no deductions for depreciation are allowable, since they represent capital expenditure. Instead, capital allowances are given under separate legislation (the Capital Allowances Act 2001). Capital allowances must be claimed and they are available for the following types of assets:
- plant and machinery (very broad definition) at 20%;
- industrial buildings at 4% (25% in qualifying enterprise zones);
- assets in a “special rate pool” (see below) at 10%;
- agricultural buildings at 4%;
- certain expenditure on mineral extraction at 10% on mineral assets and 25% on certain other expenditure;
- research and development at 100%;
- know-how at 25%;
- patents at 25%;
- dredging at 4%; and
- assured tenancies at 4%.

There is a 10% “special rate pool” for long-life assets, thermal insulation, and “integral features”.

The industrial and agricultural buildings allowances are being phased out, to be abolished by April 2011. The enterprise zone allowance will also be abolished at that time.

There are no allowances for capital expenditure on non-industrial commercial buildings (e.g. shop and office premises) outside an enterprise zone. Capital allowances are not available for expenditure on goodwill.

First-year allowances are available for certain expenses. Most of these are limited to a particular period or to expenditure in respect of trade in a special geographical area. In general, they are aimed at research and development activities, environmentally friendly technologies, and certain development areas. First-year allowances are available for the following types of expenditure:
- certain expenditure on unused energy-saving plant and machinery and water-efficient technology assets at a rate of 100%;
- expenditure on cars with low carbon dioxide emissions and on gas refuelling stations between 17 April 2002 and 31 March 2013;
- expenditure incurred after 10 April 2007 on renovation of business property that has been vacant for 1 year or more and is located in a designated disadvantaged area at a rate of 100%;
- expenditure on the conversion of buildings with certain commercial activities being carried out on the ground floor to flats (“flats over shops scheme”) at a rate of 100%; and
- expenditure on industrial buildings in qualifying enterprise zones at a rate of 100%.

A number of limitations and exclusions apply to all of the schemes.

Before April 2008, first year allowances were also available for expenditure on plant and machinery incurred by small and medium-sized businesses. However, these were abolished by Finance Act 2008. An annual investment allowance (AIA) has been introduced in their place. The AIA is available for the first GBP 50,000 of expenditure on most plant and machinery. The AIA takes effect for expenditure incurred on or after 1 April 2008.

Expenditure on plant and machinery is generally pooled for the purposes of claiming capital allowances, although certain assets, e.g. ships, make single asset pools. In addition, expenditure on know-how and patents must be pooled. For other assets, there are no pooling requirements. Finance Act 2008 provides that unrelieved expenditure in a long-life asset pool, which was in existence before 1 April 2008, may be transferred to a new 10% special rate pool. The provision applies to companies in respect of chargeable periods ending on or after 1 April 2008.

For writing-down allowances on expenditure on plant and machinery, know-how and patents, the reducing-balance method applies, while the straight-line method is used for expenditure on industrial and agricultural buildings, mineral extraction and assured tenancies.

Both first-year and writing-down allowances may be claimed in whole or in part. Normally, a claim for reduced allowances does not lead to a greater entitlement in a subsequent year. However, writing-down allowances on ships may be postponed under certain circumstances.

On the disposal of an asset, a balancing charge or a balancing allowance may be made, claiming back excess allowances or setting off remaining expenditure, respectively. Disposal events for this purpose include the sale or exchange of an asset, but also such events as the destruction or loss of an asset.

For pooled assets, the disposal value is brought into account to reduce the pool and, if it exceeds the pool, may result in a balancing charge (for plant and machinery). For the general pool and the special rate pool, there is no balancing charge until the trade is discontinued. In other cases, a balancing charge or a balancing allowance may arise.

The capital gains position of the taxpayer company is not affected by the treatment of an asset for capital allowances purposes. However, writing-down allowances may reduce an allowable capital loss. For the purpose of computing a capital gain, capital allowances are deducted from the acquisition cost to the extent that a loss would otherwise arise. In fact, all capital losses on plant and machinery are excluded, as there will always be a deemed capital allowance equal to the difference between the capital expenditure incurred and the disposal value.

1.3.6. Reserves and provisions

Reserves that are constituted by appropriations of profits (e.g. a deferred taxation reserve and a reserve for future dividends) are not deductible. Neither are general contingency reserves, such as a reserve for deferred repair and maintenance, which might be charged in the profit and loss account.

Provisions are deductible so long as they are in respect of a specific liability the amount of which has not been determined, e.g. an admitted product liability claim.

A general provision for doubtful debts such as one based on a percentage of total debts is not deductible. However, provisions for bad debts are deductible in a number of circumstances for specific proven bad debts.

Provisions for self-insurance are not deductible.

1.4. *Capital gains*

All capital gains accruing to a company are subject to corporation tax at the normal rates. However, gains arising from most sales of assets within a group are exempt, as are gains on most reorganizations of share capital. In both cases the exemption applies to both the company or companies involved and the shareholders. There are specific anti-avoidance provisions for the attribution of gains of non-resident companies which would otherwise be closely held (see 7.4.).

The acquisition or base cost deducted in computing a taxable gain is indexed by reference to changes in the retail price index from 31 March 1982, or from the date of acquisition of the asset in question. The indexation allowance cannot turn a gain into a loss, or increase a loss. Assets owned before 31 March 1982 acquire a new base cost, which is their fair market value at that date for the purpose of computing the gain, making gains up to that date tax free. An election may be made to use the actual cost, if that produces a smaller gain.

Disposals by trading companies or groups of substantial (at least 10%) shareholdings in other trading companies or groups are generally exempt. Detailed conditions and anti-avoidance provisions apply.

Rollover relief is available on the disposal of business assets of a qualifying class, provided that the proceeds from a disposal are used exclusively to acquire other business assets of a qualifying class (or an interest in such assets). If only part of the consideration is so used, the relief is reduced proportionately. The acquisition of new assets must take place in a period beginning 12 months before and ending 3 years after the disposal. Alternatively, an unconditional contract for the acquisition must be concluded within the same period, in which case the relief is granted provisionally, with the necessary adjustments taking place when all facts are subsequently ascertained.

There are eight classes of qualifying assets for the purposes of the rollover relief, including buildings and land, fixed plant or machinery, ships, satellites, space stations and spacecraft, goodwill and a number of agricultural and fish quotas.

1.5. *Losses*

1.5.1. Ordinary losses

Trading losses may be carried back for 1 year and forward indefinitely in the same and continuing trade, provided that the company remains within the charge to corporation tax. Major changes in the activities of the company may lead to there being a new trade. Any loss carried forward is set off against the earliest available trading profits. Alternatively, a trading loss may be set off against the other income (but not against franked investment income) of the company of the same or preceding accounting year and against capital gains of the same year. The set-off against capital gains is restricted to the amount that cannot be set off against the taxpayer's income for that year.

Losses in a trade concerning UK land can be set off against the total profits of the company and carried forward indefinitely. Terminal losses may be carried back for 3 years and set off against profits of any description.

Any other non-trading income losses (other than terminal losses) cannot be set off against trading profits. Such losses can only be carried forward and set off against the same class of income or capital gains.

There are restrictions on the carry-back and carry-forward of losses where there has been a substantial change in the ownership of the company. These restrictions only apply where there is a major change in the nature of the trade, or where the activities of the company's trade have become small or negligible before the change in ownership takes place and there is a subsequent revival of that trade.

1.5.2. Capital losses

Capital losses are automatically set off against capital gains of the same period; net losses may be carried forward to be set off against capital gains of subsequent years.

1.6. *Rates*

1.6.1. Income and capital gains

The main rate of corporation tax is 28%. This rate applies to all closely owned investment holding companies and to other companies with taxable profits above GBP 1.5 million.

There is also a small companies rate of 21% for profits up to GBP 300,000. Marginal relief is available on profits in the bracket between GBP 300,001 and 1,500,000, resulting in a slightly higher marginal tax rate on profits in this bracket.

Thus, the effective tax rates on profits in each income bracket are currently as follows:

Taxable profits			Rate (%)
up to		300,000	21
300,001	–	1,500,000	29.75
over		1,500,000	28

All limits for taxable profits are proportionately reduced in cases where there are associated companies, and where the accounting period is less than 12 months.

1.6.2. Withholding taxes

There are no withholding taxes on any payments to resident companies.

For withholding taxes on payments for non-residents, see 6.3.

1.7. *Incentives*

1.7.1. Research and development relief

For research and development (R&D), an immediate write-off of the expenditure is allowed. For small and medium-sized companies, there is a special regime, increasing the relief on research and development expenditure to 175%, subject to certain limitations, most importantly a required minimum spending of GBP 10,000. If the additional deduction creates a loss, this may be carried forward, surrendered by way of group relief or surrendered in exchange for a cash repayment at 14% of the surrendered loss.

Expenditure on R&D qualifies for:
– a deduction of 130% of qualifying expenditure by large companies, i.e. companies that are not small or medium-sized companies (SMEs);
– a deduction of 140% of qualifying expenditure by large companies and SMEs on research of certain vaccines for human use.

1.7.2. Tonnage tax

There is a special beneficial regime for shipping whereby profits from the operation of qualifying ships and connected qualifying activities, within certain limits, are exempt from corporation tax. Instead, corporation tax is levied on a deemed tonnage-tax profit, computed by reference to the net tonnage of ships operated by the company in question. There are elaborate ring fencing provisions excluding profits from other activities carried on by such a company from the beneficial regime.

1.7.3. Real estate investment trusts

A special regime exists for real estate investment trusts (REITs). REITs are UK-listed public companies investing in commercial real estate. REITs are exempt from corporation tax on capital gains on qualifying assets.

1.8. *Administration*

Corporation tax is administered and collected by HMRC, which appoints collectors and inspectors acting under its direction.

1.8.1. Taxable period

Unlike individual income tax and capital gains tax, which is based on the tax year (6 April to 5 April), corporation tax is imposed for a "financial year". The financial year runs from 1 April to 31 March.

Companies pay tax on a current year basis, with respect to basis periods (accounting periods). They are chargeable on the profits of the basis period ending in the year of assessment.

The basis period is the period ending on an accounting date in the financial year not less than 12 months after the trade was started. Otherwise, the basis period is the accounting period following the one that ended in the preceding financial year. Company profits arising in an accounting period are time-apportioned between the financial years in which the accounting period falls. This is particularly significant if there is a change in the corporation tax rate partway through the accounting period.

Taxpayers may change the accounting date in the first 3 years following the commencement of trading. Thereafter, a change of the accounting date may be accepted if certain conditions are fulfilled.

1.8.2. Tax returns and assessment

Assessments are made under a self-assessment regime whereby companies must compute and pay the corporation tax due within 9 months of the end of their accounting period. For instalment payments by large companies, see 1.8.3.

Corporation tax returns must be filed within 12 months of the end of the accounting period covered, or within 3 months of receiving a notice to file a tax return. Changes may be made in the return within 12 months from the statutory filing date. HMRC has 12 months to decide whether to enquire into the return.

1.8.3. Payment of tax

Large companies are required to pay their tax in four instalments on the 14th day of the 7th, 10th, 13th and 16th months following the beginning of the accounting period. A large company is a company with profits of more than GBP 1.5 million. If a company has one or more active associated companies (including non-resident companies), the threshold is reduced to an amount equal to GBP 1.5 million divided by the number of active companies in the group.

Any income tax withheld is credited against the corporation tax liability.

1.8.4. Rulings

There is no general statutory system of advance rulings. However, a number of anti-avoidance provisions contain rules on clearance procedures, allowing taxpayers to ascertain whether the legislation will be applicable before entering into a transaction.

Also, there is legislation in force providing for advance pricing agreements (see 7.2.). HMRC has also set up procedures for advance thin capitalization agreements. Where a transaction affects another jurisdiction with which the United Kingdom has a tax treaty that includes a mutual agreement procedure, that jurisdiction is invited to participate.

In addition, HMRC makes known its views on the interpretation and application of tax law on the request of taxpayers. In some cases, this has been held by the courts to be binding on HMRC under general administrative law.