Corporation tax

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 such as labour and 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. Note: capital gains on the sale of shares in a trading subsidiary may be exempt.
- 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, share of partnership income; 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. Please ask for advice.

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.

2. How much tax?

2.1 The rate at which tax is paid depends on the level of the company's profits. The corporation tax rate for the tax year 2022/23 is 19%.

2.2 Businesses with profits that can be attributed to patented inventions and certain other intellectual property can elect to pay a reduced rate of 10% tax on those profits. See 5.6.

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 online.

- The corporation tax return must be made within 12 months of the end of the period of account.

There are penalties for failing to file on time.

- If HMRC disputes any of the figures in the corporation tax return, the company may face an enquiry or a demand for extra tax. The Inspector normally has 12 months from the date the return was filed make enquiries.
- Company tax returns, corporation tax and related penalties and interest must be submitted and paid electronically.

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.
- 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% 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.

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 The introduction of a single rate of corporation tax in 2015 largely eliminated the issues surrounding the number of subsidiaries and the allocation of profits.

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 Please ask about 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. The Annual Investment Allowance limit is currently £1,000,000 per annum.
- 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.
- The company must purchase the benefit (eg medical insurance), rather than reimbursing you.

5.5 Consider using dividends, rather than a higher salary.

- A director/shareholder will receive more by way of dividend than salary due to the falling rates of corporation tax and increasing rates of National Insurance.
- You may need advice on how to structure any dividend payments. You may have to pay some salary to working shareholders to compensate them for the disproportionate dividends paid to (say) retired shareholders.
- Payment by dividend may limit your rights to state benefits and the amount you can contribute to an approved pension scheme, as the amounts do not count as earnings.

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.

5.6 Consider whether any of your profits can be attributed to intellectual property (IP).

- Under the Patent Box scheme you can elect to pay a reduced 10% rate of tax on profits associated to your IP.
- The profits must come from patent rights you sell or license, sales of patented products or products containing a patented invention, intellectual property infringement income or damages or compensation relating to your patent rights.

To claim the reduced rate, you must make an election in your tax return within two years of the end of the accounting period to which the profits relate. See the HMRC website at www.hmrc.gov.uk/ct/forms-rates/claims/patent-box.htm.

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, and may lead to increased fees.

R&D tax relief

Consider whether you can make a claim for research and development (R&D) tax relief.

A HMRC provide an additional 130% on qualifying R&D expenditure for small or medium-sized enterprises. This can:

- reduce the corporation tax payable
- provide a tax credit
- increase tax losses which can be carried forward to offset against future taxable profits (see 4)

B Large companies can also claim R&D tax relief. The uplift was 30% on qualifying R&D expenditure. Since 1 April 2013, large companies have been able to claim an 'above the line' pre-tax credit of 10%. This provides greater cashflow support to companies without corporation tax liability. Transitional rules apply until 31 March 2016 after which date it becomes mandatory.

- Companies do not have to be developing or creating leading edge technology to claim R&D relief.
- There are no spending limits.
- Losses can be carried forwards or backwards.

This information is provided for general guidance only. Please contact us if you require advice on any specific part thereon.