

Unit a: Corporation tax

A UK resident company is liable to corporation tax on its profits and capital gains arising in an accounting period. An accounting period cannot be more than 12 months.

For the financial year 2008-09:

- The main rate of corporation tax is 28%. This is charged on the whole of profits where they exceed £1,500,000.
- The small companies' rate of 21% is charged on the first £300,000 of profits. This is expected to increase to 22% in April 2009.
- Profits between the lower and upper profit thresholds (£300,000-£1,500,000), are subject to marginal relief. This is designed to ease the transition from the small companies rate to the full rate of corporation tax. The fraction used in the calculation of marginal relief is $\frac{7}{400}$ giving an effective marginal tax rate of 28%

A company's trading losses can normally be set against:

- Income and gains of the same accounting period.
- Income and gains of the previous year.
- Trading profits from the same trade in future years.

Losses of the final 12 months of a trade can be carried back three years. Losses are set against more recent periods before earlier periods.

Corporation tax liability is self-assessed and the majority of companies pay their corporation tax nine months and one day after the end of their accounting period. However, large companies are required to pay their corporation tax in four quarterly instalment payments. These payments are based on the company's estimate of its current year tax liability.

Tax on distributed profits

In addition to the general Corporation Tax charge, the 2004 Budget introduced an additional requirement that profits which are distributed (dividends) after 1 April 2004 must have suffered Corporation Tax at the small companies' tax rate. The Corporation Tax charge on profits which are left in the company and not distributed is unaffected.

Unit b: Investor taxes

4.b.1 Capital gains

SECTION AIMS

At the end of this section you should be able to:

- i) know the rate of CGT
- ii) calculate basic CGT liabilities given information relating to gains, offsetting losses and annual exemptions

Capital gains tax (CGT) is payable by UK residents on the chargeable disposal of a chargeable asset. Most assets are chargeable including shares, foreign currency and property. A chargeable disposal occurs when an asset is sold (in whole or part) or given away.

In the UK from 6th April 2008 the rate of capital gains tax for UK private investors is a flat rate of 18%. The only exception to this is a rate of 10% paid on the disposal of certain business assets (entrepreneurs relief). However, a portion of any gains made in one year is not subject to capital gains tax. For the tax year 2008-9 the exemption is £9,600. Also, only net capital gains are taxed (i.e. capital losses can be deducted from capital gains). All previous allowances for inflation and taper relief no longer apply.

To illustrate the calculation of CGT liability consider the case of Ms Smith who in the tax year 2008-9 makes capital gains of £15,000 and capital losses of £1,500. What amount of CGT should she pay?

	£
Capital gains	15,000
Capital losses	1,500
Net capital gains	13,500
Annual exemption	9,600
Amount chargeable to CGT	3,900

Capital gains tax is chargeable at a rate of 18% so the amount of tax paid by Ms Smith will be £702.

4.b.2 Income tax

SECTION AIMS

By the end of this section you should be able to:

- i) know rates of income tax applicable to earnings, dividend and interest income;
- ii) calculate the further tax liability of an investor who receives net interest or dividend income

For the tax year 2008-9 the starting rate of tax levied on personal income is 20% (reduced from 22% in the previous tax year). The higher rate of tax remains at 40%. The 10% rate of tax for earned income has been abolished but remains for savings income up to £2,300. A private investor will pay income tax on any dividends or interest received. Dividends paid by UK companies carry tax credits. These tax credits can be set against a UK resident shareholder's liability to tax on the dividend. This tax credit is 10% which satisfies lower or basic rate taxpayers' tax liability on UK dividends. Higher rate taxpayers can set the tax credit against their tax liabilities. The higher rate of tax on dividend income is 32.5%.

Unit c: Overseas taxation

4.c.1 Offsetting UK taxes against taxes levied overseas

SECTION AIMS

At the end of this section you should be able to:

- i) explain when overseas tax applies to corporate income
- ii) explain the nature and effect of double taxation treaties
- iii) calculate any further tax payable by a UK entity after double taxation relief is allowed for
- iv) explain the nature of withholding tax
- v) calculate any further tax payable by a UK entity where overseas income has been subject to withholding tax

A UK company may become subject to overseas tax when it conducts part of its operations overseas. For example a UK company may have a subsidiary based in the US. Overseas trading profits of a UK resident company are always liable to UK tax, whether the income is remitted or not. Foreign income (for example, dividends received from a foreign investment) is only taxable for a UK company if the income is remitted to the UK. So the profits earned by the US subsidiary of a UK company will be taxed by the UK tax authorities. However the US tax authorities will also tax the US subsidiary profits hence these profits are taxable twice. However the UK tax authorities have negotiated a Double Taxation Treaty with many countries. This is an agreement between the UK and the foreign country whereby relief is given by means of a tax credit which is calculated on the overseas profits at the lower of the UK and overseas company tax rate. Double Taxation Treaties have been negotiated with US, Japan, France, Germany and many other countries. Where such an agreement exists then the overseas earnings of a UK company's overseas subsidiary that are remitted to the UK would bear no UK tax if the overseas tax has been borne at a rate greater than or equal to the rate of UK corporation tax. If the foreign tax rate is lower, then the difference is payable in the UK. The following example illustrates this.

A UK company's earnings all arise overseas and bear foreign tax at 28%. UK Corporation Tax is 30% and all earnings are remitted.

	(Figures in £000's)
Pre-tax profits	2000
UK Corporation Tax liable (@ 30%)	600
less Double Taxation Relief (@ 28%)	560
UK tax payable	40

In addition to suffering foreign corporate taxes, dividends, interest or royalties remitted to the UK from certain countries may bear a further "withholding tax". For example, a UK company

receives dividends from a US subsidiary subject to 10% withholding tax. Its subsidiary's earnings are subject to 20% foreign tax. Therefore for UK tax purposes:

	£
Dividend declared from subsidiary	600,000
Foreign tax at 20/80	150,000
Gross income from subsidiary	750,000
UK corporation tax (30% on £750,000)	225,000
Double taxation relief:	
= Foreign tax + withholding tax	
= £150,000 + £60,000	210,000
Tax payable in the UK	15,000

Module 4: Key facts

Unit a: Corporation tax

4.a.1

1. The main rate of corporation tax in the UK is 28%. This is payable on profits over £1,500,000. There is also a small companies' rate of 21% which is levied on profits up to £300,000.
2. Corporation tax is payable nine months and one day after the end of a companies accounting period. However, large companies are required to pay their corporation tax in four quarterly instalment payments.

Unit b: Investor taxes

4.b.1 Capital gains

1. Capital gains tax (CGT) is payable by UK private investors at a flat rate of 18%. A portion of any gains made in one year is not subject to CGT (the annual exempt amount). Only realised net gains are taxable (ie. realised gains less realised losses).

4.b.2 Income tax

1. A private investor pays income tax on any dividends received.. A tax credit equal to 10% will be paid with the dividends and this satisfies the tax liability for basic rate taxpayers. For higher rate taxpayers the rate of tax on dividend income is 32.5%.
2. Investors who are non-taxpayers and pension funds are not able to claim back the tax paid on dividend income.

Unit c: Overseas taxation

4.c.1 Offsetting UK taxes against taxes levied overseas

1. A double taxation treaty exists between the UK and many other countries with which the UK trades.
2. The double taxation treaty provides for relief on overseas profits remitted to the UK, by way of a tax credit, calculated at the lower of the UK and overseas tax rate. Thus where the overseas corporation tax rate is the same or greater than the UK corporation tax rate, no additional tax has to be paid in the UK on overseas profits remitted.

Self-assessment questions

4.a Corporation tax

1. Large companies are required to pay corporation tax
 - (a) Every quarter
 - (b) Every six months
 - (c) Nine months after the end of the financial year
 - (d) Twelve months after the end of the financial year

4.b Investor taxes

2. An investor purchases some shares in Xanadu PLC for £40,000 and Connect PLC for £30,000. These are sold within the same tax year for £50,000 (Xanadu PLC) and £29,000 (Connect PLC). If the annual exempt amount is £9,600, and the investor is a basic rate taxpayer, what is the capital gains tax payable?
 - (a) £0
 - (b) £380
 - (c) £580
 - (d) £1,800
3. A higher rate tax payer receives a dividend payment of £800. If this is paid with an implied tax credit of 10% what is the investor's income after payment of all tax due?
 - (a) £480
 - (b) £540
 - (c) £600
 - (d) £800

4.c Overseas taxation

4. A foreign subsidiary of a UK company remits after-tax profits of £5 million to its UK parent. These profits have borne overseas corporation tax of 25%. If the UK corporation tax rate is 30%, and a double taxation treaty exists between the UK and the country where the foreign subsidiary is located, what additional tax is payable?
 - (a) £0
 - (b) £333,333
 - (c) £1,666,667
 - (d) £2,000,000

ANSWERS

1. (a)
2. (a)
3. (c)
4. (b)

