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CORPORATE TAXALERT

We had an opportunity to judge the Coalition's commitment to supporting UK small and medium sized businesses in the recent Budget announcements.

Is the Coalition good for UK business?

We already knew the main rate of corporation tax was to be reduced for the forthcoming year and for the rate to be reduced to 24% by April 2014. The surprise announcement was that for the current year there will be a 2% reduction giving a full rate of corporation tax of only 26% from April 2011. Furthermore, the 1% reductions will continue through to 2014 meaning an ultimate full rate of corporation tax of 23%. The small company rate of corporation tax reduces to 20% from the current 21% from April 2011 but there have been no announcements of further reductions in this small company rate. We will have to wait and see whether it is sustainable for a full company rate of 23% and a small company rate of 20% or whether in due course the two rates will be merged.

The lowering of corporate tax rates is just one of the measures in the Government's aim to create a competitive corporate tax regime within the major world economies, and the Government has set out their further intentions in the corporate tax road map.

British business is involved in more international trade now than at any other time in the past. This has created opportunities in some areas to operate part of the business in a jurisdiction with a lower tax rate, and the Government has historically sought measures to try and limit loss of tax revenue in this way. There was, however, a recognition within some of the Budget measures that we are operating in a global economy and perhaps falling behind some of our European and international colleagues in how we deal with international trade. There is ongoing major reform to the taxation of profits repatriated to the UK from foreign groups, and there were further measures introduced in the Budget in relation to controlled foreign companies. The Finance Bill 2011 will include measures for interim improvements to the CFC rules with more fundamental changes being proposed for 2012.

A number of organisations structure their international business through foreign branches rather than overseas subsidiaries. A foreign branch remains taxable in the UK as part of UK company profits. This can be attractive in the early phases when it may be anticipated that losses will be incurred. However, this can impose an additional significant tax burden on a company as the business begins to trade profitably. Often the branch is converted to a subsidiary when it trades profitably. New legislation in the Finance Bill 2011 will enable companies operating through foreign branches to exempt the profit of those foreign branches from UK corporation tax. To do so will require the company to make an irrevocable election to opt into the exemption regime. Once the election has been applied for it will apply to all present and future branches of the company. There are anti-avoidance provisions to restrict a company from making the election only when the branch commences to trade profitably by withdrawing the relief for losses allowed in earlier periods.

To balance the reduction in corporate tax rates there were adjustments to capital allowances, reducing the annual investment allowance from the current £100,000 to £25,000 from April 2012, and the writing-down allowance to be reduced from 20% to 18% for main pool items and from 10% to 8% for special pool items. There were, however, further additions to allowances available on green plant machinery and the introduction of a short life asset election for items sold or scrapped within an eight-year period.

The main increase in allowances was, however, in the form of enhancement to the research & development tax credit scheme for small and medium sized enterprises. At present, companies meeting the qualifying conditions for research & development projects are able to obtain an enhanced deduction of 75% of relevant expenditure. This will increase to 100% for expenditure incurred on or after 1 April 2011, and to 125% for expenditure incurred on or after 1 April 2012. These amounts are subject to the Government receiving state aid approval from the EU. There will be further enhancements to the scheme in 2012 abolishing the £10,000 expenditure condition and the rule limiting the repayable tax credit to the amount of Pay As You Earn and NIC payable.

There were a range of minor amendments for employers in relation to benefits, including an increase in the approved mileage allowance payments for mileage up to 10,000 miles to 45p, but with reductions in the benefit of childcare vouchers for higher or additional rate taxpayers from April 2011.

There were several new anti-avoidance measures, and most importantly, the new disguised remuneration legislation. These rules aim to attack arrangements whereby companies provide for past, present and future employees by means of loans or provision of assets through third parties without suffering income tax or National Insurance at the time of provision. From 6 April 2011 any such arrangements will be immediately chargeable to income tax and National Insurance on the full value of the money or asset provided.

These and other measures are outlined in full in our Budget Summary and if you would like a copy then please do not hesitate to contact us. If you have any specific queries in relation to planning for corporation tax or any corporate re-structuring proposals, then please contact either Linda Warner or Mike Walsh on 01483 416232.

When division multiplies cost

If a company has associated companies, this may have an impact on the rate of corporation tax due. This is because the profit thresholds of £300,000 and £1.5 million which determine the appropriate level of corporation tax rate must be shared equally between the company and its associated companies.

This means that a company with no associated companies is charged the small companies rate on profits up to £300,000, a company with two associated companies will only enjoy that same rate on the first £100,000 equivalent of profits as the profits threshold will have to be shared equally between the three companies (£300,000/3 = £100,000).

The following table demonstrates the impact of having associated companies on the corporation tax bill for a company with £200,000 chargeable profits using the new rates which are to apply from 1 April 2011:

- 20% on profits up to the lower threshold of £300,000
- 27.5% on profits in the range £300,001 and £1.5 million
- 26% on profits in excess of £1.5 million.

Number of associated companies	Lower profit threshold	Rates to apply	Corporation tax due
0	£300,000	20% only	£40,000
1	£150,000 (as divided by 2)	20% on first £150,000 then £50,000 @ 27.5%	£43,750
2	£100,000 (as divided by 3)	20% on first £100,000 then next £100,000 @ 27.5%	£47,500

It is clearly the case that identifying the correct number of associated companies is essential in determining the correct corporation tax charge.

How to identify an associated company

A company is associated with another company if one of them has control of the other or if both are under the control of the same company or individual(s). The shares of direct relatives, business partners in certain situations and some trustees can be attributed to the individual for the control test. In a situation where spouses each own separate companies their shares are attributed to the other with the result that both companies are treated as controlled by the same individual. This means that the two companies are deemed associated even where they are, in all other respects, independent operations.

The precise application of these so called attribution rules in other situations can be complex so professional advice is recommended in interpreting when and how to apply them.

Changes ahead

However, a change to the associated company rules to be included in the Finance Bill 2011 may at least offer some relief to spouse controlled companies with effect for accounting periods ending on or after 1 April 2011.

It is proposed to amend the circumstances in which rights held by linked persons are attributed to each other to establish control. Attributions will only be made where there is 'substantial commercial interdependence' between the businesses being run in the companies. So, where spouses each separately control their own company and there is no commercial interdependence between the companies, each company will have the use of their own profit limits.

There will clearly be many small and medium sized companies where family shareholding attributions could deem companies to be associated. The identification of whether there is substantial commercial interdependence may therefore be vital for the operation of the correct corporation tax rate.

When considering whether there is 'substantial commercial interdependence' HMRC will have regard to the degree of financial, economic or organisational links which exist, or have existed, or might be expected to exist between the relevant activities/companies involved.

If you consider these matters may affect you please do not hesitate to get in touch with Mike Walsh on 01483 416232 or email him on mwalsh@roffeswayne.com.

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iXBRL – the importance of getting it right

It has been possible for some time now for the majority of corporation tax returns to be submitted to HM Revenue and Customs (HMRC) online. This has been done by preparing the return in XML (Extensible Markup Language) and attaching pdf copies of the accounts and tax computations. Prior to this, all tax returns, accounts and computations had to be submitted in paper form and many returns were still being filed either in paper form, or online with pdf attachments, until 31 March 2011 when the rules changed.

So why the change? What was wrong with paper returns or online returns with pdf attachments? The problem in both cases as far as HMRC was concerned was that the data could not be read by a computer. If they wanted to run statistical comparisons based on information in the accounts, or on the computations, they had to type the data in by hand. In this age of radical cost-cutting across government departments, HMRC have reduced manpower and have become much more reliant on computers to monitor tax compliance. iXBRL shifts the responsibility for getting the information into a computer readable format.

HMRC will ultimately use all of this newly available electronic information to compare one year of accounts against another and to compare one business against another business, opening enquiries where their computer identifies significant or unusual deviations from the standard. They will be able to do this because iXBRL accounts are precisely 'tagged' using the UK taxonomy. If items are incorrectly tagged it may still be possible to file the accounts as HMRC have stated that no corporation tax returns will be rejected due to inaccurate tagging. The problem will come when HMRC's computer checks the validity of the data at a later date and decides it falls outside expected parameters, increasing the risk of an enquiry. The enquiry risk may not be felt immediately but will increase over the next few years.

To combat this problem we have sophisticated and versatile software that pre-tags the most common items in a set of accounts and greatly reduces the risk of a tagging related enquiry.

Please contact Peter Lucas on 01483 416232 or plucas@roffeswayne.com if you have yet to decide how to tag your accounts and would like more details.