# Excerpt from Revenue Law: Principles and Practice – Chapter 42 – Corporation Tax

## Section 6
Business enterprise

## Chapters


Introduction to business tax

42 Corporation tax

43 Company distributions and shareholders

44 Corporate groups

Introduction to partnership tax

45 The taxation of partnerships

46 Limited liability partnerships

47 Choice of business medium

48 Incorporations, acquisitions and demergers


Introduction to business tax

***Updated by Stephen Whitehead, KPMG LLP (UK)***

Businesses operating in the United Kingdom – and, indeed, elsewhere in the world – are potentially subject to three main categories of taxation which are dealt with in the next three sections of this work. These are:

(a) direct taxes calculated on business profits and other income and capital gains (see this section);

(b) taxes on turnover, principally VAT (see **Section 7**);

(c) taxes on capital transactions (see **Section 8**).

*1 Direct taxes*

Since 1965 the taxation of business income in the UK has been divided between two distinct and separate taxes depending on the legal form of organisation of the enterprise concerned. Companies which are resident or trading in the UK are subject to corporation tax, whereas all other enterprises – principally sole traders and partnerships, including limited liability partnerships carrying on a trade or business – are subject to income tax.

The year 1965 also marked the introduction on a permanent basis of taxation of capital gains in the UK. This again is divided between two taxes, since capital gains of companies are included in their profits subject to corporation tax, whereas gains of other enterprises are charged to capital gains tax.

### a) Corporation tax

Corporation tax applies to all resident bodies corporate including authorised unit trusts and unincorporated associations (see *Blackpool Marton Rotary Club v Martin* (1990)) but not to partnerships (although see below in relation to limited liability partnerships) or to local authorities, which are bodies corporate but are exempt from income tax, corporation tax and capital gains tax. It is levied on the profits of a company that are made up of income, charged to tax in accordance with the provisions of the Corporation Tax Acts 2009 and 2010, and chargeable gains computed generally in accordance with the principles applying for CGT.

The UK system of corporation tax was, until April 1999, generally referred to as the *imputation* system as part of the tax paid by the company was imputed to the shareholder by means of a tax credit attached to dividends paid to shareholders. Thereafter, a tax credit, at a reduced rate, continued to be attached to dividends but was no longer linked to tax paid by the company and could not be paid out to the shareholder. From 6 April 2016, the last vestiges of the imputation system were eliminated with the abolition of dividend tax credits.

The Corporation Tax Act 2009 (CTA 2009), dealing with trading, property and miscellaneous income, has effect for accounting periods ending on or after 1 April 2009. Remaining corporation tax matters are to be found in the Corporation Tax Act 2010 (CTA 2010) and in the Taxation (International and Other Provisions) Act 2010 (TIOPA 2010), the latter relating mainly to international matters affecting companies, and both of these Acts apply for corporation tax purposes to accounting periods ending on or after 1 April 2010.

Under this legislation, companies are taxed on different types of income under provisions that mirror the format of those in ITTOIA 2005, and there are specific corporation tax rules that are explained below for matters such as loan relationships and gains on 'new' intangible assets. Legislation relating to capital allowances, which replace depreciation as a deduction for tax purposes, is not contained in the two Corporation Tax Acts but in separate legislation which applies both for corporation tax and income tax (see **CHAPTER 11**).

### b) Income tax

Profits of enterprises carried on by individuals, whether alone or in partnership, are subject to income tax as explained in **SECTION 2** and in **CHAPTER 45**. Where, however, a partnership consists of or includes companies, those companies' shares in the profits of the partnership will instead be included in their profits subject to corporation tax.

A limited liability partnership (LLP) is a form of legal entity which was introduced with effect from 2001. Although a body corporate, it has some of the characteristics of a partnership and generally, so long as it carries on a trade, profession or business with a view to profit (and is not in liquidation), its members will be subject to tax on its profits as if they were partners in a partnership (see **CHAPTER 46**).

Income tax will also apply to the profits of companies to the extent that they are distributed to members who are individuals, as explained in **CHAPTER 43**. In addition, companies and others carrying on a business need to be aware of their obligations in relation to the deduction of tax from payments to employees as set out in **[8.191]** et seq.

The differential tax treatment of different forms of business organisation may be a significant factor in the choice of business medium, as discussed in **CHAPTER 47**.

### c) Tax on disposals of assets

As already noted, gains on disposals of assets will be subject to capital gains tax in the case of individuals and to corporation tax in the case of companies. These taxes will be relevant when capital assets of the business are disposed of, but will also need to be considered – as will various other potential tax liabilities – on any acquisition, reorganisation or disposal of the business itself or part thereof, as discussed in **CHAPTER 48**.

## 2 *Turnover taxes*

In the UK, since accession to the European Community (as it then was) in 1971, the principal turnover tax has been Value Added Tax (VAT), as it is throughout what is now the European Union (EU). VAT is dealt with in detail in **SECTION 7** of this work, but some introductory comments will be given here.

VAT is harmonised throughout the EU, which means that national legislation in each country implements the principles and detailed provisions set out in the EU VAT Directive and other provisions of EU law, and that its operation is ultimately subject to the decisions of the Court of Justice of the EU. While initially seen by many as a relatively simple and straightforward tax, it has developed a substantial body of legislation and case law and is now understood to be far from straightforward.

Other indirect taxes are permitted under the EU VAT Directive provided that they cannot be characterised as turnover taxes. In the UK this includes insurance premium tax, excise duties and the so-called 'environmental taxes'. A new digital services tax is to be introduced with effect from April 2020 and will be charged at 2% on the revenues of search engines, social media platforms and online marketplaces which derive value from UK users. This is intended as an interim measure and the Government is committed to disapplying it once an appropriate international solution to the tax challenges arising from digitalisation is in place.

VAT or a similar tax also exists in many other countries throughout the world, but while these regimes have many common features they also differ widely in detail. The forthcoming exit of the UK from the EU is not expected to result in a move away from VAT as a method of collecting revenue, but may well lead to a gradual divergence of the UK's system of VAT from that applying in the EU.

### *3 Transaction taxes*

Formerly, in the UK, 'transaction taxes' meant stamp duty, which is strictly a tax on documents and differs in many practical ways from most other taxes encountered by businesses. While stamp duty still exists, its significance was greatly reduced following the introduction, firstly of Stamp Duty Reserve Tax (SDRT), which applies to transfers of securities, and secondly of Stamp Duty Land Tax (SDLT), which applies to transactions in land but has itself now been replaced in Scotland and Wales by devolved taxes. These taxes are discussed in detail in **CHAPTER 45**. Most businesses will need to deal with these taxes only occasionally, as a result of reorganisations or of acquisitions or disposals of capital assets, but their impact when they do arise can be significant.

# 42

# Corporation tax

***Updated by Stephen Whitehead, KPMG LLP (UK)***


I General principles – rates of corporation tax **[42.1]**

II How to calculate the profits of a company **[42.21]**

III Raising finance **[42.71]**

IV Close companies **[42.91]**

V The overseas dimension **[41.111]**

VI Corporate self-assessment **[41.141]**


## I General principles – rates of corporation tax

Corporation tax is charged by reference to financial years (FY) that run from 1 April to 31 March and are referred to by the calendar year in which they commence. Hence, FY 2019 means the financial year from 1 April 2019 to 31 March 2020. Where companies are wound up, the rate charged during their final financial year is generally that fixed for the preceding financial year (CTA 2010 s 628). With effect from 1 April 2015 a single rate of corporation tax applies to all companies except in relation to ring-fence profits (for which see

[42.4]). This rate is 19% for FYs 2017–2019 and, as provided in FA 2016, is to be reduced to 17% for FY 2020.

Before 1 April 2015 there were two rates of corporation tax:

(1) the small profits rate (20% for FY 2014, see [42.3]);

(2) the full rate (21% for FY 2014).

For FY 2015–FY 2016 the rate of 20% applied to all companies.

The rates applicable for FY 2012 to FY 2019 are shown in the following table:

**Align to: n-Para; Table width: 0; Range to: left; Font size: 0; Column ratio: 0,0; Point alignment: auto**

| *FY* | *Main rate* | *Small profits rate* |
|---|---|---|
| FY12 | 24% | 20% |
| FY13 | 23% | 20% |
| FY14 | 21% | 20% |
| FY15–FY16 | 20% | not applicable |
| FY17–FY19 | 19% | not applicable |

Corporation tax is charged on a current year basis on the company's profits for the financial year. Therefore, where a company's accounting period straddles two financial years the profits must be apportioned on a time basis (CTA 2009 s 8(5)). The following example illustrates the computation problem with a change in the full rate.

*Example 42.1*

Grr Ltd makes up its accounts to 31 December 2017 and its trading profits are £2,000,000. The rate of corporation tax for FY 2016 is 20% and for FY 2017 is 19%.

The tax will be calculated as follows:

*Profits of £2,000,000 apportioned:*

1 January 2017–31 March 2017:

3/12 of £2,000,000 = £500,000 taxed at 20% (FY 2016)

1 April 2017–31 December 2017:

9/12 of £2,000,000 = £1,500,000 taxed at 19% (FY 2017)

For all except large companies the tax is payable within nine months and one day after the end of the company's accounting period. Hence, in *Example 42.1* the tax would normally be due by 1 October 2018. The position of large companies is considered at [42.145].

**[42.1]**

*1 Capital gains*

Capital gains realised by a company are included in its profits and charged to corporation tax at the same rate as the company's income. The corporation tax rate on chargeable gains for FY 2019 is thus 19%. Where the accounting period straddles two financial years, chargeable gains are apportioned between them on a time basis in the same way as income (see *Example 42.1*), so that the rate does not depend on the financial year in which the gain actually accrues.

Unlike individuals, companies are not entitled to an annual exemption; the indexation allowance continues to apply to capital gains made by companies but is frozen from 1 January 2018 so that for subsequent disposals the index figure for December 2017 is used.

Disposals of shareholdings in other companies may be exempt from tax subject to the conditions of the Substantial Shareholdings Exemption (see **[42.53]** below).

Intangible assets created or acquired after 1 April 2002 are outside the rules for corporation tax on chargeable gains and are covered by special rules contained in CTA 2009 Part 8 (see **CHAPTER 49**).

**[42.2]**

*2 The small profits rate (CTA 2010 s 18)*

The small profits rate (previously, but less accurately, called the 'small companies' rate') applied to any company (other than a close investment holding company: see **[42.99]**) whose profits, both income and capital, did not exceed the 'lower limit' in the accounting period.

Where a company's profits exceeded the lower limit but not the upper limit a marginal relief was available. For financial years prior to 2014 the lower limit was £300,000 and the upper limit was £1,500,000. The effect of this was (for FY 2014) to impose corporation tax at the rate of 21.25% on profits above £300,000 but below £1,500,000. For FY 2012 this marginal rate was 25% and for FY 2013 23.75%. For this purpose profits included franked investment income (FII) (see **[42.26]**) unless received from a company in the same 51% group or, subject to certain conditions, from a company owned by a consortium of which the receiving company was a member (see also **[43.71]**). If the company had associated companies (see below), the lower and upper limits were divided by the total number of associated companies including the taxpayer company.

If a company wished to take advantage of CTA 2010 s 18 it was required to submit a claim in the company's return that the profit should be charged at the small profits rate or that marginal relief was appropriate. Any such statement also needed to indicate whether or not there were associated companies (see SP 1/91; for the treatment of companies between which there was no substantial commercial interdependence, see FA 2011 s 55; for the position of holding companies, see SP 5/94 and for companies which were not carrying on any trade or business at any time during the accounting period, see *Jowett v O'Neill and Brennan Construction Ltd* (1998), *Land Management Ltd v Fox* (2002) and *R & C Comrs v Salaried Persons Postal Loans Ltd* (2006)). Non-resident companies could be associated companies as could companies controlled by spouses, certain relatives and business partners and also companies owned by trusts in relation to which a connected person was a settlor (see *R v CIR, ex p Newfields Developments Ltd* (2001), HL).

Changes in the small profits rate may be tabulated as follows:

**Align to: n-Para; Table width: 0; Range to: left; Font size: 0; Column ratio: 0,0; Point alignment: auto**

| *FY* | *Small profits' rate (%)* | *Marginal rate (%)* |
|---|---|---|
| 2012 | 20 | 25 |
| 2013 | 20 | 23.75 |
| 2014 | 20 | 21.25 |

*Example 42.2*

(1) Zee Ltd makes up its accounts to 31 March each year. For the year ending 31 March 2015 the company had trading profits of £80,000 and made chargeable gains of £42,000.

The profits of Zee Ltd for corporation tax purposes were:

**Align to: n-Para; Table width: 0; Range to: left; Font size: 0; Column ratio: 0,0; Point alignment: right**

| | £ |
|---|---|
| Trading (ie income) profits | 80,000 |
| Chargeable gains | 42,000 |
| Chargeable profits | £122,000 |

Zee Ltd, therefore, qualified for the small profits rate so that corporation tax was charged as follows:

Chargeable profits (£122,000) at 20% = £24,400

(2) Had the income profits of Zee Ltd been £280,000 then, with the addition of chargeable gains (£42,000), the small company threshold of £300,000 would have been exceeded by £22,000 so that the small profits relief would have applied as follows:

**Align to: n-Para; Table width: 0; Range to: left; Font size: 0; Column ratio: 0,0; Point alignment: right**

| | | |
|---|---|---|
| (i) | Corporation tax payable: | £ |
| | £322,000 (ie £280,000 + £42,000) × 21% | 67,620 |
| (ii) | Less: marginal relief (CTA 2010 s 19): | |
| | (upper relevant amount – profits) × statutory fraction | |
| | ie (£1,500,000 – £322,000) × 1/400 | 2,945 |
| (iii) | Total tax ((i) – (ii)) | £64,675 |

Two points should be stressed in connection with the small profits rate: *first*, as noted above, provisions were made to prevent the fragmentation of a business among associated companies in an attempt to create a series of small companies (CTA 2010 s 24(3)). This restriction only applied if the associated company was carrying on a trade or business at any time in the relevant accounting period: see s 25(3) and *Jowett v O'Neill and Brennan Construction Ltd* (1999) in which retaining a large sum of money in a bank account was not considered to involve a trade or business; for further discussion, see also *Land Management Ltd v Fox* (2002) and *R & C Comrs v Salaried Persons Postal Loans Ltd* (2006).

*Example 42.3*

X Ltd has three wholly owned operating subsidiaries. The companies are associated and hence the lower and upper limits for each company are divided by one plus the number of associated companies. The lower and upper limits for each company in the X Group for FY 2014 were, therefore, £75,000 and £375,000.

A company was treated as an associated company of another company if the same person controlled both companies (see *Steele v EVC International NV* (1996) and CTA 2010 s 25(5): control for these purposes was construed in accordance with CTA 2010 s 450 on which see *R v IRC, ex p Newfields Developments Ltd* (2001)).

*Second*, the marginal rate applied where profits fell between the lower and upper limits, and the tax on profits in excess of the lower limit was therefore charged at an effective rate in excess of the main rate. This is because the purpose of the small profits relief was to increase gradually the average rate of corporation tax from the lower rate payable by a company with profits at or below the lower limit to the higher rate payable by a company with profits at or above the upper limit. To achieve this result the rate applicable to the slice of profits between the lower and upper limits had to *exceed* the main rate. For FY 2014 this marginal rate was 21.25% calculated as follows:

**Align to: n-Para; Table width: 0; Range to: left; Font size: 0; Column ratio: 0,0; Point alignment: auto**

| | | |
|---|---|---|
| Tax on £300,000 at 20% | = | £60,000 |
| Tax on £1,500,000 at 21% | = | £315,000 |
| Difference (£315,000 – £60,000) | = | £255,000 |

Therefore, £255,000 corporation tax has to be raised on profits falling between £300,000 and £1,500,000 (ie on £1,200,000).

Hence, as a percentage, tax on £1,200,000 would have been:

$$\frac{255{,}000}{1{,}200{,}000} \times 100 = 21.25\%$$

Thus, continuing *Example 42.2(2)* above:

Corporation tax of £64,675 on profits of £322,000 could be analysed as:

**Align to: n-Para; Table width: 0; Range to: left; Font size: 0; Column ratio: 0,0; Point alignment: auto**

| | | |
|---|---|---|
| | | £ |
| First £300,000 of profits at 20% | = | 60,000 |
| Final £22,000 of profits at 21.25% | = | 4,675 |
| | | £64,675 |

In determining whether small profits relief was available, dividends received from other UK companies (franked investment income) were taken into account, but not dividends from the company's own subsidiaries (see **[43.71]** ff for further explanation of franked investment income and for an illustration of how this affected small profits relief).

With effect from FY 2015, the small profits rate no longer applies to most companies although there is still a differential rate in respect of ring fence profits (see **[42.4]**). As a result of the unification of corporation tax rates the rules for identifying associated companies are no longer needed and have been repealed. Small profits relief for ring-fence profits is instead given by reference to the number of 'related 51% group companies' – that is, active companies within a 51% group. The provisions relating to capital allowances for long-life assets, patent box small company treatment and corporation tax instalment payments, which previously depended on the definition of associated companies, were also amended accordingly.

**[42.3]**

*3 Corporation tax on ring fence profits*

Separate rates and fractions apply to corporation tax on ring fence profits of North Sea oil companies since FY 2007. The rates for FY 2007–2019 are given in the table below:

Align to: n-Para; Table width: 0; Range to: left; Font size: 0; Column ratio: 0,0; Point alignment: auto

| | |
|---|---|
| *Financial year* | *2007–19* |
| Main tax rate | 30% |
| Small profits rate | 19% |
| Lower limit | £300,000 |
| Upper limit | £1,500,000 |
| Marginal relief fraction | 11/400 |
| Marginal rate | 32.75% |

Where companies have both ring fence profits and other profits, there are special rules which have the effect of applying the appropriate rates to each part of the total profits.

As explained above (see **[42.3]**), a company's franked investment income, though not subject to tax, was taken into account in applying the profit limits for small profits relief. With effect from 6 April 2016, following the abolition of dividend tax credits, the net amount of any exempt distributions is included and this amount is identified as 'exempt ABGH distributions'.

**[42.4]**

*4 Northern Ireland rate*

CTA 2010 Part 8B, which was inserted by the Corporation Tax (Northern Ireland) Act 2015, gives the Northern Ireland Assembly the power to set a rate of corporation tax to apply to Northern Ireland trading profits. There are complex provisions to determine which profits or losses qualify as Northern Ireland profits or losses for this purpose. No date has yet been set for these provisions to enter into force.

**[42.5]–[42.20]**

## II How to calculate the profits of a company

Profits of a company are defined as including both income profits and capital gains (CTA 2009 s 2(2)).

**[42.21]**

*1 Income profits*

### a) General principles

CTA 2009 marked a decisive move away from the former dependence of corporation tax law on income tax rules, and also from the system of schedules and cases which was first introduced by Addington in 1803. The rules for computation of income for corporation tax purposes are now set out in full in CTA 2009 itself, in CTA 2010 and in TIOPA 2010.

Thus, a trading company having no other income will compute its profits in accordance with the rules set out in CTA 2009 Part 3. In general the rules for what expenditure is deductible by companies correspond to those applying to individuals and partnerships (discussed at **[10.130]**). Accordingly, for example, the salaries and fees paid to the company's directors and employees will be allowable expenses under CTA 2009, Part 3, Chapter 4.

However, the moves taken to align tax treatment of company profits with accounting treatment have resulted in some divergences of corporation tax rules from income tax rules. The loan relationship rules (see **[42.30]**) and the rules for taxation of intangible assets in CTA 2009 Part 8 are two examples.

So far as income from land is concerned, FA 1998 extended treatment of property rental income as a deemed business to companies and this is now dealt with in CTA 2009 Part 4 (for the income tax provisions relating to property income, see **CHAPTER 12**). In particular, so far as companies are concerned:

(1) rental income from non-UK property is treated as the receipts of a separate business;

(2) in the context of group relief a distinction is drawn between 'true' trading losses and losses from a property business;

(3) CTA 2010 Part 14, Chapter 3 deals with changes in ownership of a company with investment business (see **[42.45]**);

(4) in computing property business income, related interest costs, exchange gains and losses etc are dealt with under the separate loan relationship rules which apply to companies (see **[42.30]** ff).

A problem in the case of a corporate group may arise from the common assumption that it represents a single commercial entity. This is not the case for tax purposes and so an expense may be non-deductible in the hands of the paying company if that expense was incurred for 'dual purposes': eg to benefit other group members (*Commercial Union Assurance Co Ltd v Shaw* (1998); however, see also *Vodafone Cellular Ltd v Shaw* (1997) where the Revenue was unsuccessful with a similar argument and **[44.21]**). As a separate matter, a special rule introduced with effect from 19 March 2014 denies a deduction where there is an avoidance scheme involving a transfer of profits within a corporate group (CTA 2009 s 1305A).

An enhanced deduction is available for costs in relation to removing harmful substances from contaminated land. Essentially, a company may claim an enhanced deduction of 150% of costs relating to land remediation. If this deduction creates or increases a loss then a tax credit of 16% of the qualifying loss can be claimed from HMRC; this is not proposed to be limited to PAYE payments as under the R&D scheme from 1 April 2020 (CTA 2009 Part 14).

The system of capital allowances applies to companies with suitable modifications (see **CHAPTER 11**). The specific difficulties that may arise when an existing business is transferred to a company are dealt with in **CHAPTER 48**.

A review of the corporation tax computation by the Office of Tax Simplification was published on 3 July 2017 and included an extensive range of proposals, some of which were characterised as 'quick wins' while other more radical reforms were proposed for the medium or long term. While the Government responded positively to the overall direction of the report, there have been no clear steps to implement the proposed changes.

**[42.22]**

### b) Foreign exchange gains and losses and financial instruments for managing interest rate and currency risk

For accounting periods beginning on or after 1 October 2002 the rules for the taxation of exchange gains and losses and on interest rate and derivative contracts are included in the rules which apply to loan relationships in CTA 2009 Part 5; see CTA 2009 s 328 for exchange gains and losses and CTA 2009 Part 7 for derivative contracts.

**[42.23]**

### c) Transfer pricing (TIOPA 2010 Part 4)

The transfer pricing legislation is aimed at transfer pricing arrangements entered into by multi-national corporations. Such corporations can exploit the tax rules in the various jurisdictions to obtain a tax advantage. The rules provide that where any two persons have entered into a transaction which confers on one of them a UK tax advantage, the profits and losses of the advantaged party must be computed as if the transaction had been undertaken on arm's length terms. The company has to be satisfied that its transfer pricing policy meets HMRC's requirements and that arm's length prices are adopted in order to be sure that the profits and the tax in its CTSA return are calculated correctly. If the company fails to consider whether its arrangements are in accordance with the arm's length principle, penalties apply. The other party to the transaction may obtain relief through the competent authority procedure and, in the case of UK to UK transfer pricing rules, through corresponding adjustments.

Non-UK resident companies can also be subject to the transfer pricing regime. For example, a property investment company resident in Jersey may seek to eliminate any UK tax liability on rents received from a property situated in this country by borrowing the purchase price from an associated company and claiming the interest on that loan as a deduction from the rents. If the loan is not one that would have been made between non-associated companies dealing at arm's length and a UK tax advantage has resulted, the transfer pricing rules can operate to disallow the interest deduction and therefore to increase the UK taxable property income of the Jersey company.

This principle arguably extends to third party loans which are supported or guaranteed by a connected person (eg a group member) and enables HMRC to disallow part or all of the interest paid on such a loan. HMRC may also use CTA 2009 s 443 to deny interest relief where arrangements have been entered into with the sole or main benefit being the obtaining of a deduction for the interest paid.

The transfer pricing rules apply to provision made or imposed between any two persons where the 'participation condition' is met. The condition is met if one person is directly or indirectly participating in the management, control or capital of the other or a third person is directly or indirectly participating in the management, control or capital of both. In determining whether a person is indirectly participating in the management, control or capital of another person at a particular time, additional rights and powers may be attributed including those which the person is entitled to acquire at a future date or will, at a future date, become entitled to acquire.

The rules on indirect participation also cover joint venture arrangements where a person has a 40% interest and another person also has 40% of the company. The scope of the rules is further extended to apply where persons 'act together' in order to finance a company, even though none of these persons has control for the purposes of the transfer pricing legislation. These rules are mainly aimed at private equity-funded companies but may catch other arrangements.

From 1 April 2004, transfer pricing applies to UK-to-UK transactions as well as those involving counterparties who are not UK taxpayers. There is, however, an exclusion for small enterprises in most circumstances and a more limited relief for medium-sized enterprises and for dormant companies.

The definition of small and medium is derived from EU rules:

- Medium-sized
  - fewer than 250 employees; and
  - either turnover less than €50m (c £43m); or
  - assets less than €43m (c £37m)
- Small
  - fewer than 50 employees; and
  - turnover or assets less than €10m (c £9m).

Detailed guidance has been provided by HMRC to assist businesses to comply.

The measures abolish separate thin capitalisation requirements and subsume them within general transfer pricing requirements and allow the connected UK business to make a corresponding adjustment in the calculation of its taxable income.

TIOPA 2010 Part 5 sets out the procedure to be followed by companies wishing to come to an advance agreement with HMRC on their transfer pricing policy (an 'advance pricing agreement'). This process also applies to Advance Thin Capitalisation Agreements and Statement of Practice 1/12 sets out how the legislation will be applied in practice in such cases.

**[42.24]**

### d) Employee trusts

Payments into employee trusts may constitute deductible expenditure if they are of an income nature (see *Heather v P-E Consulting Group* (1978), discussed at **[10.133]**). See also *Mawsley Machinery Ltd v Robinson* (1998) where the payments were disallowed as they were for the purpose of providing a fund to purchase the company's shares and *McDonald v Dextra Accessories Ltd* (2005) where payments were not allowed as a result of the restriction imposed under CTA 2009 s 1288 where emoluments are not paid within nine months of the end of the accounting period. In this case a deduction will only be given when emoluments are actually paid to employees.

A tax deduction for contributions to an employee trust (which includes a payment of money or the transfer of an asset) is only allowed to the extent that the money or the asset is used within nine months of the end of the accounting period in providing qualifying benefits. These are payments or transfers of assets that give rise to a charge to income tax and NIC (see CTA 2009 ss 1290–1297). These rules do not apply to most retirement benefit schemes or to share-related benefits where a statutory tax deduction is allowed.

**[42.25]**

### e) Dividends and income taxed at source

Dividends and other income distributions received are generally exempt from corporation tax whether or not the paying company is resident in the UK, provided they fall into an exempt class and are not caught by anti-avoidance provisions. Different rules apply depending on whether or not the recipient company is classed as small, but the anticipated effect is that the great majority of distributions received in each case will be exempt. The exemption also applies to certain distributions of a capital nature. Until 5 April 2016 a UK-resident company which received an exempt qualifying distribution, whether or not paid by a UK-resident company, was entitled to a tax credit equal to one-ninth of the distribution, although this credit was not payable to the company and was not taxable. The dividend together with the tax credit constituted franked investment income (FII). The rules are contained in Part 9A of CTA 2009, which was inserted by FA 2009 and formed part of the 'foreign profits package' (see further **[42.77]**).

When income is received by a company net of income tax deducted at source, the gross income is included in the profits of the company and a credit is given from the corporation tax payable for the tax deducted at source.

Interest and other annual payments do not need to have income tax deducted at source where the recipient company is UK resident or where it is a non-resident company carrying on a trade in the UK through a permanent establishment and the payment is brought into charge in the UK.

*Example 42.4*

Lexo Ltd makes up its accounts to 31 March each year. The accounts for the period ending 31 March 2020 show the following:

**Align to: n-Para; Table width: 0; Range to: left; Font size: 0; Column ratio: 0,0; Point alignment: right**

| | |
|---|---|
| | £ |
| Trading profit | 260,000 |
| Profit from lettings | 40,000 |
| Royalty received: | |

| | | |
|---|---|---|
| Net | £60,000 | |
| plus tax deducted | £15,000 | |
| Gross | | 75,000 |
| Total profits | | £375,000 |
| | | £ |
| Corporation tax payable: | | |
| £375,000 at 19% (FY 2019) | | 71,250.00 |
| Less: tax deducted | | 15,000.00 |
| | | £56,250.00 |

*Notes:*

(1) The trading profit is calculated according to the rules of CTA 2009 Part 3, and the profit from lettings according to the rules of CTA 2009, Part 4.

(2) If the tax deducted exceeded the corporation tax payable, the excess would be repaid to the company.

**[42.26]**

*2 Capital gains*

**a) Basics**

A company's chargeable gains are computed in the same way as those of an individual. The definition of chargeable assets and the occasions when a disposal occurs are common to both individuals and companies. The annual exemption (£12,000 for 2019–20) is not available for disposals by companies and nor is entrepreneurs' relief. Indexation allowance, which in the case of assets with a high base cost was a substantial advantage, was retained for corporation tax after its abolition for capital gains tax, but is now frozen as at December 2017. The rules for the exemption of tax on the disposals by a trading company of a substantial shareholding in another trading company under TCGA 1992 Sch 7AC are examined at **[42.53]**.

**[42.27]**

**b) Intra-group disposals**

A disposal between companies in the same group is treated as giving rise to neither gain nor loss until the asset is disposed of outside the group or the recipient company leaves the group within six years (see **[44.122]**).

**[42.28]**

**c) Dangers of a double charge**

A disadvantage suffered by a company and its shareholders is that on any capital gain realised by the company there may be an element of double taxation. Not only will the company suffer corporation tax on the gain, but the shareholder whose shares may have increased in value as a result of the capital profit (albeit after tax) will suffer CGT when he disposes of those shares.

*Example 42.5*

S Ltd (a company wholly owned by John) makes a chargeable gain of £100,000. It will suffer corporation tax of £19,000 (19%) on that gain. John's shares will have increased in value by, say, £81,000 so that were he to sell them he would suffer CGT of up to £16,200 if the entire gain is taxed at 20% (ignoring exemptions and reliefs). Effectively, therefore, the corporate gain has been subject to tax at 35.2% (19% paid by the company and 16.2% by John).

The effect of entrepreneurs' relief, available to individuals and trustees, will have an impact. If full entrepreneurs' relief for a business asset (giving a rate of tax of 10% for smaller gains instead of 20%) is available then the total tax would be 27.1% (19% plus 10% of 81%).

Holding appreciating assets in private companies therefore can be tax-inefficient and in some circumstances it may be better for the shareholder to retain those assets and lease them to the company. However, this judgment needs to take into account other reliefs (such as entrepreneurs' relief), and the effect on other taxes such as inheritance tax and stamp duty.