

# Corporate and Business Tax

## Corporation tax rates

Legislation will be introduced in Finance Bill 2011 to reduce the main rate of corporation tax from 28% to 26% for the Financial Year commencing 1 April 2011 and then to 25% for the Financial Year commencing 1 April 2012. The main rate of corporation tax generally applies to companies with profits of more than £1.5 million. It had previously been announced that the main rate would reduce from 28% to 27% followed by further 1% graduated reductions until it reached 24% by 1 April 2014. Instead the main rate is set to reduce to 23% by 1 April 2014.

The small profits rate of corporation tax, which generally applies to companies with up to £300,000 of profits, is to reduce from 21% to 20% also with effect from 1 April 2011. This had already been announced.

The effective marginal corporation tax rate for profits between £300,000 and £1.5 million will be 27.5% from 1 April 2011.

## Associated companies for corporation tax rates

The upper and lower limits for corporate tax rates are divided equally between a company and its 'associated' companies. 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 person(s).

The shares of direct relatives, business partners and some trustees can be attributed to a person for the control test. For example if a husband owns no shares in a company, he may be deemed to own the company via his wife's shareholding.

A change to the associated company rules will be included in Finance Bill 2011 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 between them to establish control. Attributions will only be made where there is 'substantial commercial interdependence' between the businesses being run in the companies.

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.

## The Corporate Tax Road Map

The government's aim is to create the most competitive corporate tax regime of the major world economies.

The Corporate Tax Road Map sets out how the government intends to approach reform of the corporate tax system over the next five years.

The principles it will adopt include:

- lowering corporate tax rates but reducing the reliefs and allowances available
- avoiding unnecessary changes to tax legislation and ensuring that any changes improve the long-term stability of the corporate tax system
- adapting the tax system for the effects of globalisation and technological developments over the last 20 years.

The focus of the Road Map is on large corporates as these increasingly operate across national borders and may choose not to have their headquarters in the UK.

The main areas of tax changes in the next five years will be to the:

- Controlled Foreign Company (CFC) regime
- taxation of innovation and intellectual property (IP)
- taxation of foreign branches.

## **CFC reform**

Currently the CFC rules may apply where a UK company has a subsidiary which operates in a country with a relatively low rate of corporate tax. In certain circumstances the profits of the subsidiary may be subject to UK corporate tax.

Interim improvements to the existing CFC rules will be introduced in Finance Bill 2011 and more fundamental proposed changes have been announced for consultation with interested parties. The legislative outcomes of the proposals will be included in Finance Bill 2012.

The main interim improvement will be to exempt a CFC which carries on a range of 'foreign to foreign' activities involving transactions wholly or partly with other group companies. The new rules will have effect for accounting periods beginning on or after 1 January 2011.

The more fundamental proposed changes will operate in a targeted and more territorial way by bringing within a CFC charge only the proportion of overseas profits that have been artificially diverted from the UK. A consultation document describing the new regime is to be published in May 2011 followed by draft legislation in autumn 2011 for inclusion in Finance Bill 2012.

## **Taxation of innovation and IP**

The government is consulting on a preferential regime for profits arising from patents, to be known as a Patent Box. The intention is to introduce a 10% corporation tax rate for profits arising from patents from 1 April 2013. A consultation document will be issued in May 2011 with legislation proposed for Finance Bill 2012.

## Research and Development (R&D) Tax Credits

Subject to State aid approval, legislation will be introduced in Finance Bill 2011 to increase the rate of the additional deduction for expenditure on R&D for companies that are small or medium-sized enterprises (SMEs) from 75% to 100% for expenditure incurred on or after 1 April 2011, giving a total deduction of 200%. The rate of Vaccine Research Relief for SMEs will be reduced to 20% from the same date.

The government also plans to introduce further changes subject to consultation and State aid approval in Finance Bill 2012 in respect of expenditure incurred on or after 1 April 2012 as follows:

- to abolish the rule limiting a company's payable R&D tax credit to the amount of PAYE and NICs it pays
- to abolish the £10,000 minimum expenditure condition
- to change the rules governing the provision of relief for work done by subcontractors under the large company scheme
- to increase the rate of the additional deduction for expenditure on R&D for SMEs by a further 25% to give a total deduction of 225%
- Vaccine Research Relief will not be available for SMEs.

## Taxation of foreign branches

A foreign branch exists when a UK company carries on part of its trade in another country without establishing a separate trading subsidiary.

Legislation will be introduced in Finance Bill 2011 to exempt the profits of foreign branches of UK resident companies from corporation tax, precluding the need for credit relief to prevent double taxation.

The exemption will only apply if companies irrevocably elect to opt into the exemption regime. The election will apply to all present and future branches of the company.

Otherwise the existing rules will apply.

## Corporate capital gains simplification

Following extensive consultation on simplification of the capital gains rules for groups of companies, legislation will be introduced to modernise the 'degrouching charge' rules.

Under current law, if a company leaves a group holding an asset acquired from a fellow group member within the previous six years, any gain or loss that had been deferred on that asset acquisition is reinstated as a chargeable gain or loss (a degrouching charge) separate to any gain or loss incurred on the disposal of the shares in the company.

It is proposed that where a company leaves a group as a result of a disposal of its shares, any degrouching charge will be treated as additional consideration for the disposal. This ensures that shareholder reliefs, such as the substantial shareholdings exemption, will also apply to the degrouching charge.

Changes to the degrouching charge rules will apply to deemed disposals made on or after Royal Assent.

Other proposed changes to corporate capital gains are to:

- remove some existing restrictions on the use of capital losses within a group of companies after acquisition of a business
- replace a complex set of anti-avoidance rules on 'value shifting' with a clearer purpose-based rule.

## Capital allowance changes

Finance Bill 2011 will include the following previously announced reductions to capital allowances from April 2012:

- a reduction in the Annual Investment Allowance from the current £100,000 to £25,000
- a reduction in the writing down allowance rates from 10% and 20% to 8% and 18% respectively.

## Short life asset extension

Legislation is to be introduced to enable businesses incurring expenditure on an item of plant or machinery from April 2011 onwards to make a short life asset (SLA) election in respect of that item if they expect to sell or scrap it within an eight year cut-off period. This is an extension from the current four year cut-off period. The cut-off period starts at the end of the chargeable period in which the expenditure is incurred.

The impact of an SLA election is that the item is placed into a single asset pool. Entitlement to capital allowances until the asset is sold or scrapped follows normal rules but on disposal any remaining balance after taking account of disposal proceeds is allowed as a further allowance. This is the advantage of such an election but a charge can arise instead where overall allowances and disposal proceeds exceed the original expenditure.

## Review of green technology lists

Businesses purchasing designated plant and machinery which is energy saving, reduces water use or improves the quality of water are eligible for 100% capital allowances. The qualifying technologies are reviewed annually. The main change this year includes the addition of a new technology - efficient hand dryers. Also the qualifying criteria for automatic metering and targeting equipment will be simplified.

## Review of IR35

Following publication of the Office of Tax Simplification's review of small business tax, the government has decided to retain IR35 as abolition would put substantial revenue at risk. The government will however make improvements in the way IR35 is administered. The improvements will include guidance on those types of cases HMRC view as outside the scope of IR35.