RELEVANT TO ACCA QUALIFICATION PAPER F6 (UK) AND PERFORMANCE OBJECTIVES 19 AND 20

Overseas aspects of corporation tax

This article is relevant to candidates sitting the Paper F6 (UK) exam in 2012, and is based on tax legislation as it applies to the tax year 2011–12 (Finance Act 2011).

Overseas aspects of corporation tax may be examined as part of question two, or it could be examined in questions four or five.

Company residence
Companies that are incorporated in the UK are resident in the UK. Companies that are incorporated overseas are only treated as being resident in the UK if their central management and control is exercised in the UK. Companies that are resident in the UK (or treated as being resident in the UK) are subject to UK corporation tax on their worldwide profits (including chargeable gains).

EXAMPLE 1

Crash-Bash Ltd is incorporated overseas, although its directors are based in the UK and hold their board meetings in the UK.

- Companies that are incorporated overseas are only treated as being resident in the UK if their central management and control is exercised in the UK.
- Since the directors are UK based and hold their board meetings in the UK, this would indicate that Crash-Bash Ltd is managed and controlled from the UK, and therefore it is resident in the UK.
- If the directors were to be based overseas and to hold their board meetings overseas, the company would probably be treated as resident overseas since the central management and control would then be exercised outside the UK.

Overseas branch compared to an overseas subsidiary company
It is important to appreciate the difference between operating overseas through a branch and operating overseas through a subsidiary company. An overseas branch of a UK company is effectively an extension of the UK trade, and 100% of the branch profits are assessed to UK corporation tax. There are a number of factors that have to be considered when deciding whether to operate overseas through either a branch or a subsidiary company.

EXAMPLE 2

Union Ltd is a UK resident company that is planning to set up an overseas operation. It is unsure whether to operate overseas through a branch or a subsidiary company.

- Relief will usually be available for trading losses if incurred by an overseas branch. UK relief is available for trading losses incurred by an overseas subsidiary company.
- UK capital allowances will be available in respect of plant and machinery purchased by an overseas branch. Allowances will not be available for expenditure incurred by an overseas subsidiary company.
- An overseas branch cannot be an associated company. An overseas subsidiary will be an associated company, and so the UK corporation tax limits will be reduced accordingly.
- The profits of an overseas branch are liable to UK corporation tax in the year that they are made, regardless of whether they are remitted to the UK. An overseas subsidiary company will not be liable to UK corporation tax.

Double taxation relief

Double taxation will occur where an overseas branch's profits are taxed overseas as well as being subject to UK corporation tax. Double taxation relief will be available in respect of the overseas tax, up to the amount of the UK tax on the overseas profits.

EXAMPLE 3

Gong Ltd is a UK resident company with an overseas branch. The results of Gong Ltd for the year ended 31 March 2012 are as follows:

	Total	**UK**	**Branch**
	£	**£**	**£**
Trading profits	400,000	270,000	130,000

Overseas corporation tax of £26,000 was paid in respect of the overseas branch's trading profit.

The corporation tax liability of Gong Ltd for the year ended 31 March 2012 is as follows:

	Total	UK	Branch
	£	£	£
Trading profits	400,000	270,000	130,000
Taxable total profits	400,000	270,000	130,000
Corporation tax at 26%	104,000		
Marginal relief			
3/200 (1,500,000 – 400,000)	(16,500)		
	87,500	59,063	28,437
Double taxation relief	(26,000)		(26,000)
	61,500	59,063	2,437

• The UK corporation tax on the UK profit is £59,063 (87,500 x 270,000/400,000), and on the overseas branch profit it is £28,437 (87,500 x 130,000/400,000).

• The overseas branch has paid overseas corporation tax of £26,000, and this is lower than the related corporation tax liability of £28,437.

Where a company pays gift aid donations then these should initially be set against the UK profit, with any unrelieved balance set against the overseas branch profit with the lowest rate of overseas tax. This approach will maximise the amount of available double taxation relief.

EXAMPLE 4

Zing Ltd is a UK resident company with two overseas branches. The results of Zing Ltd for the year ended 31 March 2012 are as follows:

	Total	UK	First branch	Second branch
	£	£	£	£
Trading profits	180,000	8,000	92,000	80,000

During the year ended 31 March 2012 Zing Ltd paid gift aid donations of £20,000.

Overseas corporation tax of £9,200 was paid in respect of the first overseas branch's trading profit, and overseas corporation tax of £24,000 was paid in respect of the profits of the second branch.

The corporation tax liability of Zing Ltd for the year ended 31 March 2012 is as follows:

	Total	**UK**	**First branch**	**Second branch**
	£	**£**	**£**	**£**
Trading profits	180,000	8,000	92,000	80,000
Gift aid donations	(20,000)	(8,000)	(12,000)	0
Taxable total profits	160,000	0	80,000	80,000
Corporation tax at 20%	32,000		16,000	16,000
Double taxation relief	(25,200)		(9,200)	(16,000)
	6,800		6,800	0

• The first overseas branch has paid corporation tax at the rate of 10% (9,200/92,000 x 100) whilst the second overseas branch has paid corporation tax at the rate of 30% (24,000/80,000 x 100).

• The balance of the gift aid donations of £12,000 are therefore deducted from the profits of the first overseas branch since it has paid the lower rate of corporation tax.

• The second overseas branch has paid overseas corporation tax of £24,000, but double taxation relief is restricted to the related UK corporation tax of £16,000.

Overseas dividends
As far as Paper F6 (UK) is concerned all overseas dividends are exempt from UK corporation tax.

Exempt overseas dividends are included as franked investment income when calculating a company's augmented profits in exactly the same way as UK dividends, unless they are group income. In this case they are completely ignored for tax purposes.

EXAMPLE 5

During the year ended 31 March 2012 Various Ltd, a UK resident company, received an overseas dividend of £67,500 (net). Withholding tax was withheld from the dividend at the rate of 15%.

- If Various Ltd owns 50% or less of the voting power of the overseas company, then the overseas dividend will be exempt from UK corporation tax but included as franked investment income. The amount of franked investment income is £75,000 (67,500 x 100/90).
- If Various Ltd owns more than 50% of the voting power of the overseas company, then the dividend will be exempt from UK corporation tax and not included as franked investment income. This is because the overseas dividend is group income.

Transfer pricing
The transfer pricing rules prevent UK companies from reducing their taxable total profits subject to UK corporation tax by, for example, making sales at below market price to an overseas subsidiary company, or purchasing goods at above market price from an overseas holding company.

EXAMPLE 6

Frodo Ltd, a UK resident company, exports goods that it has manufactured to its overseas subsidiary company at less than their market price.

- Invoicing for the exported goods at less than the market price will reduce Frodo Ltd's UK trading profit and hence UK corporation tax.
- A true market price must therefore be substituted for the transfer price.
- The market price will be an 'arms length' one that would be charged if the parties to the transaction were independent of each other.
- Frodo Ltd will be required to make the adjustment in its corporation tax self-assessment tax return.

Conclusion
The overseas aspects of corporation tax, at the Paper F6 (UK) level, are fairly straightforward provided you know the main principles involved. Working through the examples in this article should prepare you for anything that might be set in the examination.

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