OVERSEAS ASPECTS OF CORPORATION TAX

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This article is relevant to candidates sitting Paper F6 (UK) in either June or December 2013, and is based on tax legislation as it applies to the tax year 2012–13 (Finance Act 2012).

Overseas aspects of corporation tax may be examined as part of Question 2, or it could be examined in Questions 4 or 5.

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 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 2

During the year ended 31 March 2013 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.

Overseas branches

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. Double taxation relief is then given where an overseas branch's profits are also taxed overseas. Relief is restricted to the amount of UK tax on the overseas branch's profits. If an overseas branch makes a trading loss then the loss can be relieved against UK profits.

Example 3

Gong Ltd is a UK resident company with an overseas branch. For the year ended 31 March 2013 the company made a trading profit of £370,000, and the branch made a trading profit of £30,000. Overseas corporation tax of £6,300 was paid in respect of the overseas branch's trading profit.

Gong Ltd's corporation tax liability for the year ended 31 March 2013 is as follows:

UK trading profit	370,000
Overseas branch	30,000
	________
Taxable total profits	400,000
	________
Corporation tax at 24%	96,000
Marginal relief 1/100 (1,500,000 – 400,000)	(11,000)
	________
	85,000
Double taxation relief	(6,300)

	78,700

- The overseas branch has paid overseas corporation tax of £6,300, and this is lower than the related UK corporation tax of £6,375 (85,000 x 30,000/400,000).

As an alternative to this treatment it is possible for a company to elect to simply treat the profits of all of its overseas branches as being exempt from UK corporation tax. The election, once made, is irrevocable, and it applies to all of a company's overseas branches. The election must be made before the start of an accounting period to which it is to apply.

An election will not be beneficial if a company has a loss making overseas branch, since if an election is made any trading loss of an overseas branch will not be relievable when calculating taxable total profits. Even if a branch is currently profitable, a company might decide not to make an election if double taxation relief means there is little or no UK corporation tax liability in respect of the branch profits. This will mean that relief will then be available should the branch make a loss at some point in the future.

Example 4

Brown Ltd is a UK resident company with two overseas branches. For the year ended 31 March 2013 the company made a trading profit of £210,000. The first overseas branch made a trading profit of £40,000 for the year ended 31 March 2013. Overseas corporation tax of £6,000 was paid in respect of this profit. The second overseas branch made a trading loss of £25,000 for the year ended 31 March 2013. Brown Ltd has not made an election to exempt the profits of its overseas branches.

Brown Ltd's corporation tax liability for the year ended 31 March 2013 is as follows:

UK trading profit	210,000
First overseas branch	40,000
Second overseas branch	(25,000)

Taxable total profits	225,000
	________
Corporation tax at 20%	45,000
Double taxation relief	(6,000)
	________
	39,000
	________

- The first overseas branch has paid overseas corporation tax of £6,000, and this is lower than the related UK corporation tax of £8,000 (40,000 at 20%).

If Brown Ltd had made an election to exempt the profits of its overseas branches prior to 1 April 2012, then its corporation tax liability would have been as follows:

UK trading profit	210,000
	________
Taxable total profits	210,000
	________
Corporation tax at 20%	42,000
	________

Therefore an election would not have been beneficial.

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 (if no election for exemption is made) 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 5

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 100% subsidiary company.

If no election for exemption is made

- Relief will usually be available for trading losses if incurred by an overseas branch. As far as Paper F6(UK) is concerned, no 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.
- 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.
- 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.

If an election for exemption is made

- As far as the calculation of taxable total profits is concerned, there will be no difference whether Union Ltd operates through an overseas branch or an overseas subsidiary company.
- However, the UK corporation tax liability could be higher as a result of operating through an overseas subsidiary company since this will be an associated company.

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 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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