

Planning for corporation tax in 2023 (Lecture B1297 – 19.34 minutes)

For the financial year 2023:

- the main rate of corporation tax will be 25% (S6(2)(b) FA 2021); and
- a so-called standard small profits rate of 19% is being introduced for companies with 'augmented profits' of £50,000 or less (S7(2)(a) FA 2021).

The relevant details about the standard small profits rate are spelled out in Ss18A – 18J CTA 2010. The £50,000 limit is specified in S18D(2)(a) CTA 2010.

A company's augmented profits for an accounting period comprise:

- its profits chargeable to corporation tax for that period; plus
- its non-group distribution income received (S18L CTA 2010).

The full rate of 25% applies to companies with augmented profits of £250,000 or more (S18D(2)(b) CTA 2010). This rate is also chargeable on the profits of close investment companies and non-UK resident companies with UK source income or gains, regardless of the level of their profits (ie. even if the profits are less than £250,000).

Companies with augmented profits below £250,000 but greater than £50,000 will be liable at the main rate of 25%, but that charge is then reduced by a marginal relief.

The marginal relief formula is set out in S18B(2) CTA 2010 as follows:

$$F \times (U - A) \times N/A$$

where:

- F = the standard marginal relief fraction;
- U = the upper limit;
- A = the amount of the augmented profits; and
- N = the amount of the taxable total profits.

The special fraction for profits falling into the marginal zone is 3/200ths (S7(2)(b) FA 2021). The effective rate of tax on profits in the marginal zone is 26.5% and this can be demonstrated by comparing the tax on profits at the upper limit and the tax on profits at the lower limit. Thus:

	£		£
Upper limit	250,000	25%	62,500
Lower limit	<u>50,000</u>	19%	<u>9,500</u>
Difference	<u>200,000</u>	26.5%	<u>53,000</u>

The upper and lower profit limits are reduced on a pro rata basis where there are one or more associated companies (S18D(3) CTA 2010). For an accounting period of less than 12 months in length, the limits contract on a time basis (S18D(4) CTA 2010).

Illustration 1

Ted Enterprises Ltd has one wholly owned subsidiary. For the year ended 31 March 2024, the company's taxable profits amount to £100,000. It has no non-group dividend income.

For a company with one associated company, the upper profit limit is £125,000 and the lower profit limit is £25,000.

Ted Enterprises Ltd's taxable (and augmented) profits are £100,000. The company's corporation tax liability for this accounting period is calculated as follows:

	£
100,000 @ 25%	25,000
Less: $3/200 \times (125,000 - 100,000)$	<u>375</u>
	<u>24,625</u>

This produces an overall tax rate of 24.625%, but another way of showing the liability is to tax the first £25,000 at the standard small profits rate and the balance at the marginal rate. Thus:

	£
25,000 @ 19%	4,750
75,000 @ 26.5%	<u>19,875</u>
	<u>24,625</u>

The need to prorate the upper and lower profit limits between associated companies can have a seriously distortive effect on the aggregate tax liability where profits accrue unevenly across a group.

Illustration 2

Bertram Ltd, Reginald Ltd and Wilberforce Ltd are associated companies for the 12-month accounting period ended 31 March 2024.

Their respective taxable profits are:

	£
Bertram Ltd	3,000
Reginald Ltd	30,200
Wilberforce Ltd	16,800

Where there are three associated companies, the upper and lower profit limits are £83,333 and £16,667.

Because of the size of its profits, Bertram Ltd will pay corporation tax at the standard small profits rate, whereas Reginald Ltd and Wilberforce Ltd both fall into the marginal zone.

Thus:

Bertram Ltd 3,000 @ 19%	<u>£570</u>
Reginald Ltd 30,200 @ 25%	7,550
Less: $3/200 \times (83,333 - 30,200)$	<u>797</u>
	<u>£6,753</u>
Wilberforce Ltd 16,800 @ 25%	4,200
Less: $3/200 \times (83,333 - 16,800)$	<u>998</u>
	<u>£3,202</u>

This gives rise to an aggregate corporation tax liability of $£570 + £6,753 + £3,202 = £10,525$ on combined profits of £50,000.

On the other hand, a single company with taxable profits of £50,000 would pay tax at the standard small profits rate.

Thus:

50,000 @ 19%	£9,500
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This represents a saving of £1,025. From a corporation tax planning point of view, Illustration 4 represents the importance of trying to even out the profits of group members.

Where an accounting period straddles the introduction of the FA 2021 regime, the company's profits are apportioned between those falling into the financial year 2022 (which are taxed at 19%) and those falling into the financial year 2023 (which are taxed at the appropriate rate depending on the level of profits for that period, with the upper and lower profit limits being proportionately reduced). This apportionment must be done on a time basis (S52 CTA 2009) – for more details, see Para CTM01405 of the Company Taxation Manual.

Illustration 3

Derek Industries Ltd draws up its accounts to 30 June each year. The company has taxable profits of £360,000 for the year ended 30 June 2023. There are no associated companies.

The profits falling into the financial year 2022 are $9/12 \times £360,000 = £270,000$ (although, strictly speaking, this apportionment should be done on a daily basis). These profits will be taxed at 19%.

For the financial year 2023, the upper and lower profit limits are reduced on a pro rata basis to reflect the fact that only three months of the accounting period are included in the financial year 2023. The upper profit limit is $3/12 \times £250,000 = £62,500$ and the lower profit limit is $3/12 \times £50,000 = £12,500$. The profits apportioned to this financial year are $3/12 \times £360,000 = £90,000$. Given that this figure exceeds the upper profit limit for the period, the corporation tax charge will be at 25%.

Thus:

	£
Financial year 2022	
270,000 @ 19%	51,300
Financial year 2023	
90,000 @ 25%	<u>22,500</u>
	<u>73,800</u>

This represents an overall rate of 20.5%.

Companies and their advisers wishing to mitigate the impact of the tax rate increase which will take effect on 1 April 2023 should note the following:

1. Where profits are likely to exceed the lower profit limit of £50,000, it will be worthwhile trying to establish whether profits can be accelerated so that they are chargeable in the financial year 2022 rather than in the financial year 2023.
2. Where the rate of corporation tax after 31 March 2023 is likely to be higher than 19%, it will be sensible for the company to delay any allowable expenditure in order to secure relief at a higher rate.
3. If the company has been making trading losses, will it be more beneficial to carry them forward rather than to carry them back? Remember that loss carry-forwards can now be set against total profits instead of (as used to be the case) against future profits from the same trade. In other words, is it preferable to obtain relief potentially at a higher rate or to have an earlier relief (or repayment), but at a lower rate?
4. Give careful thought to the impact of associated companies and consider whether some form of restructuring might be advantageous.

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