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CORPORATE INCOME TAX REGIME

A Consultation Response Document

GR 013/06

Issued by:

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Background and purpose of this document

On 4 October 2005 the Income Tax Division issued the 'Corporate Income Tax Regime – Proposal Document' as part of a public consultation dealing with proposed changes to the way in which companies are taxed in the Isle of Man.

The proposal document sought the views of company officers, tax professionals and individual taxpayers who, directly or indirectly, are involved with the taxation of companies on the following topics:

- Scope
- Rates of income tax
- Basis of assessment
- Returns
- "Pay and file"
- Computation of profits
- Transition
- Relationship with the new distributable profits charge ('DPC')
- Capital allowances
- Group and loss relief.

In addition, as part of the consultation process, the Income Tax Division held a seminar on 18 October 2005 at the Manx Museum that was attended by 180 tax professionals.

The Assessor welcomes the contributions made during the seminar and in the form of written responses to the consultation. This document provides an overview of the responses received by the Division and, where possible, its view regarding the way forward.

1. Scope

The new corporate income tax regime will cover all entities defined as "corporate taxpayers" (a term including companies and certain bodies corporate). For simplicity, we will use the word "company" instead of the phrase "corporate taxpayer" throughout this response document.

Income tax will continue to be charged on a company's worldwide profits. We envisage that the new regime should apply in respect of periods of account ending after 5 April 2007.

Consultation Response:

- Concern was raised that Income Tax Division may find it difficult to ensure that legislation, etc. is in place for March 2007 with all other changes that are occurring at present.

- It was suggested that in view of the move to the 0% rate it may no longer be necessary to change the way in which companies are taxed. To move to a pay and file system when the majority of companies will not be paying anything

(except perhaps the DPC) seems to be a pointless exercise. Taxpayers and advisers will have to manage awkward transitional computations when there is going to be no tax liability at the end.

- Advisers were informed during a presentation at the Villa Marina that it was desirable that companies distribute sufficient profits to avoid exposure to the DPC; this will be a lot easier if we retain the current 5 April year end basis.

- Unlike the proposed New Manx Vehicle, these proposals make a lot of work for accountants, but local people are the ones who are going to have to pay for the extra accountancy work required. Local people are going to feel victimised three times over, firstly by the tax on participator loans, secondly by the DPC and thirdly by the extra costs of adjusting to the new regime, transitional arrangements etc.

Treasury Response

Consultation on this subject started in the early 1990s, when a Manx 'pay and file' system was proposed by the Corporate Tax Working Party. Further consultation took place in 2003 and again in October 2005. Many contributors have expressed support for bringing in a system that is used internationally and which will bring the taxation of Manx companies in line with the international norm.

The move to a general 0% rate of income tax leads the Division to consider the need to change the current system and to ask whether it might be better, at a time of great change in other areas of taxation, to retain the current provisions for the filing of tax returns and the payment of tax.

The rate of tax applying to company profits is, however, only one factor. Treasury has looked at other aspects including:

- workflow for the Income Tax Division and company advisers;
- the adoption of a current year (CY) accounts period basis of assessment;
- the repeal of legislation (particularly that covering thousands of tax exempt companies – 'TECs');
- the need to update the compliance regime for company tax returns; and
- the fact that a small number of companies will pay a significant amount of tax via the application of the 10% rate.

Looking at the different areas in turn:

Workflow

Currently, and regardless of year end, all companies receive a tax return or TEC application shortly after the end of the tax year. The returns should be filed no later than the following 6 October, with the resultant tax liability being due on 1 January. TEC applications should be filed before 30 June, or later on payment of an increased fee. This system forces a number of processes (for the Division and company advisers) into a short period. In practice, the bulk of tax returns are filed during the late summer and early autumn. Treasury sees the adoption of the proposed new rules as likely to spread

the workload across the year and reduce pressure in October (filing), November (default assessments) and January (payment).

Adoption of the CY accounts period basis of assessment

Currently, companies in the Isle of Man are taxed on a 'previous year basis', which means strictly assessment to tax of the profits earned within the previous tax year from 6 April to 5 April. We allow, by concession, the profits of the accounting period falling in the previous year to be the basis on which tax is assessed. The system features complexities in relation to commencement and cessation of business and changes of accounting date. The move to a statutory CY accounting period basis of assessment will remove the complexities associated with commencement and cessation and will simplify the handling of year end changes. This basis of assessment is very much the international norm.

Repeal of legislation

The Income Tax (Exempt Companies) Act 1984 states that when a company ceases to be tax exempt it will be subject to tax using the commencement provisions contained in the Income Tax Act 1970. If the previous year basis was to be retained, it would be necessary to assess all tax exempt companies in accordance with the current commencement provisions (adjusting profits for up to 4 years), yet, in the majority of cases, no tax will be due because of the 0% rate. The adoption of the CY accounts period basis of assessment is seen as a mechanism to bring all companies onto the same basis of assessment at the same time – albeit subject to transition for current taxpaying companies.

Compliance

Where a tax return is filed late the Division issues a default assessment and can charge interest where tax is not paid on time, and tax-based penalties where profits are omitted or understated. The move to the general 0% rate would make the charging of interest and tax-based penalties impossible. The Division sees the proposed new system for the filing of tax returns and the payment of tax, including a fixed penalty regime for late filing, as a suitable alternative. If a fixed penalty regime were introduced in conjunction with the current filing deadline, the single date-driven pressure on advisers to get returns in on time would remain. Spreading the work throughout the year could relieve pressure on advisers and the Division at the times stated previously.

Companies taxed at 10%

The proposed new system will provide certainty to taxpaying companies with regard to the tax return filing requirement and the payment of tax.

Treasury has considered the proposed new system in the context of a general 0% tax rate and has concluded that it is appropriate to introduce many of the aspects of pay and file mentioned in the proposal document by way of an Income Tax Bill.

The remaining sections of this response document summarise specific comments made during the consultation period and, where necessary, provide a statement of Treasury's position in relation to particular areas.

2. Rates of income tax

The proposal document set out seven schedules of income and rates of tax applying to them. The schedules were:

- income derived by licensed banks from banking business (schedule I, 10%),
- income derived by licensed banks from the investment of their reserves and regulatory capital (schedule II, 2% or 0%),
- income derived from the post-importation retailing or wholesaling of goods in the Island by branches and subsidiaries of non-resident companies (schedule III, 10%),
- income from land and property in the Isle of Man (schedule IV, 10%),
- all other forms of income not taxable under schedules I to IV (schedule V, 0%),
- income of companies that elect to pay at a higher rate than the standard rate (schedule VI, 10%), and
- understatement of company profits (schedule VII, 20%).

Further information relating to the proposed schedular system was included in the "Taxation Strategy – Consultation Document" that was also issued on 4 October 2005.

Consultation Response:

- Support was expressed regarding the introduction of a schedular system, subject to the writer's concern about how complex the Manx tax system has become over the last 6 or 7 years – with the schedular system adding to the complexity.

- Specific reference was made to the schedule III rate (post-importation, etc. income):

    - The schedule should not inadvertently catch business currently conducted via exempt companies. The wording or any proposed regulation would have to carefully considered, subject to adequate consultation with interested parties.

    - Some retailers sell both local produce and imported foods (for example); will it be necessary to split accounts? If so, it should be noted that some retailers' accounting systems may not enable to distinguish between the profits of the different product types – for some companies accounts are already being prepared (e.g. 30 April year end) which will require such a split ahead of the 2006/2007 assessment.

    - Will the Division come under pressure from other local sectors for a similar approach to be adopted?

- Comments relating to the proposed schedule VI were:

    - Will the 10% election rate only apply with regard to trading income or will include investment income?

- What is the position where a trading company making an election to be taxed at 10% is in receipt of non-trading investment income that would otherwise fall within the 100% distribution requirement under the DPC regime?

Treasury Response

Treasury agrees with the comments made with regard to the schedular system and notes the concerns regarding TECs and certain retail sectors.

The election to pay 10% will not apply to investment income, other than that income which is determined to be part of the working capital of a trading concern. This issue links with the determination of distributing status for a company that is subject to the DPC; if a company elects to pay 10% on taxable profits then it will avoid exposure to the DPC on those profits. A company subject to the effective 18% DPC on distributable profits will not be able to make the election.

Further details in respect of the schedular tax system for companies were announced by the Treasury Minister in the Budget on 21 February 2006.

3. Basis of assessment

Most of the contributors made reference to this section of the proposal document. Support for the accounting period basis of assessment was given by some, although one contributor opposed it. Specific comments included:

- The proposals seem sensible and if legislation is based upon similar tried and tested legislation such as in the UK then the ITD and the taxpayers will have reference material for guidance.

- The contributor who opposed the concept based his opposition on the misconception that the company would be required to pay tax during the period of account, in advance of its year end and before some of the profits had been earned.

Treasury Response

With regard to the second comment above, and to clarify the position, whilst the proposal document sought views on the introduction of an accounting period basis of assessment, it also sought views on the payment of tax nine months after the end of the accounting period, thereby allowing for the preparation of financial statements and accounts.

The Income Tax Division is <u>not</u> looking at a "payment on account" system (similar to that used for individuals), which would require payment of tax before the end of the accounting period.

Given the simplification and workflow benefits that would follow, Treasury will introduce an accounts period basis of assessment for companies.

4. Returns

This section discussed the date on which tax returns should be filed, the introduction of flat rate penalties for late submission, further penalties where returns were habitually late and other tax-based penalties, including penalties for investigation and enquiry cases. This part also asked whether there should be a statutory requirement to notify the Assessor that a company has commenced to trade.

Section 5 considers in detail the 'pay and file' concept, and comments relating to the filing of returns have been included within that section. The comments here summarise the position set out by contributors with regard to notifying the Assessor when trade commences, where there is a failure to make a return or where the return is incomplete in some way.

Regarding the requirement to notify the Assessor of the commencement of trade, specific comments included:

- On the basis that companies will be required to file tax returns under a self assessment style regime, I do not consider that there is any need for a company to specifically notify the Assessor when it commences to trade.

- Many companies are dormant and are suspended from the requirement to make a return. If this system is to continue, and this would seem sensible, then a notification system will be required to cover the position where they cease to be dormant. If, however, a company has to complete a return every accounting date, no notification will be required.

- It is unfortunate to use the word trade as it would imply that you do not want to also know about the commencement of an investment business which is not a trade.

- From my experience it is common for newly incorporated trading companies to be late filing their initial tax returns. This is usually because no financial year end has been chosen, the company has no accountant and there is nothing to prompt any action. The Assessor should issue a return and a "declaration" of trading status with suitable notes shortly after incorporation; these would draw attention to the time limits and penalties. The "declaration" should be submitted as soon as trading commences; there might even be a penalty for failing to do so.

Regarding flat rate penalties and an investigation rate of tax, comments included:

- The FSC are looking to introduce late filing penalties which treat incomplete returns as not filed. If incomplete means the lack of documents, for example, audited accounts which are not available by the filing date, this could be very harsh. The return should not be rejected for this alone if draft accounts are submitted in good faith with the proviso that the audited accounts are to follow in a strictly limited time.

- I accept the need to introduce flat rate penalties for late submission of returns to encourage better compliance by corporate taxpayers. However, I consider that the penalties suggested within the Document are excessive. The writer suggested that the initial penalty should be no more than £100, the extended penalty no more that £200 and the habitual penalty no more than £500.

- Quantum of fees is too high; UK rates are lower and if HMRC had found that they were not working then they would have sought an increase, but they have not.

- Concern has been expressed regarding the proposed introduction of a criminal offence for the officers of a company if the return is more than 24 months late. There are on occasion situations where, through no fault of the company's officers, a return is more than 24 months late. In such circumstances it would be wholly inappropriate for the officer concerned to be facing criminal action.

- Impact on current tax exempt and non resident companies should be considered. Such companies will (initially) not be familiar with the completion of returns.

- If higher penalties are required, some form of transition (using lower amounts in earlier years) should be considered. A second writer suggested some form of phased approach, perhaps over 2 or 3 years to give companies, and their agents, a period to become familiar with the new regime.

- Tax based penalties should be designed to ensure prompt submission of returns where tax is at stake. If a company is subject to a 0% rate, no tax is lost or delayed and penalties should only be geared to the administrative costs of the late return which will be the same for all companies. Where a DPC is due, the penalties should only be based upon the DPC and as already envisaged, in that legislation.

- It is still unclear to me whether or not a company that is liable to 0% tax and wholly owned by non-residents (and as such is outside the scope of the DPC) would be required to file accounts and tax computations with its annual tax return. I assume that such a company will simply be required to "tick-the-box" in some way i.e. there would be no requirement to file tax computations or accounts, or report to the Division a taxable profit figure. If this is the case, then it would e wholly inappropriate to introduce a form of penalty linked to the profits of the company.

- I recognise the importance of tax / DPC / profit-geared penalties to those companies liable to 0% tax that are within the DPC regime. In principle, it seems reasonable that penalties should be based upon the profits within the scope of the DPC. However, I would like to see some examples of how the Division see the proposals working in practice.

- It is vital that the investigate rate of tax does not inadvertently catch those companies that are liable to 0% tax and wholly owned by non-residents.

- For a company that is liable to tax at 10%, I see no need to introduce an investigation rate of tax – the existing tax geared penalty regime will presumably suffice.

- Current penalties have maximum of double tax due for errors and treble for fraud and negligence. Such penalties are rarely applied with the rate being mitigated down to as low as 10% in some cases. To increase the penalties to 200% seems very harsh.

- To have the same rate for innocent errors and for fraudulent and negligent errors does seem unfair and harsh.

- Penalties should apply equally to all companies. This means the current exempt companies, as well as other companies that will be 0% rate companies. This would mean current exempt companies having to submit returns and tax computations. This will be an added expense and something they are not used to doing.

- If the object with such a rate is to encourage those subject to the DPC to get their computations correct so that the DPC can be correctly calculated then surely the penalty should be a DPC penalty or a DPC rate where the company's tax rate is 0%.

- Unless there is actual fraud, in tax matters, tax based penalties are always preferable to criminal sanctions. Upsetting as it maybe to have unresolved open years, this should not be treated as a criminal offence. It was wrong to introduce Section 111J and it should not be extended here.

- The 0% need not render tax-based penalties redundant. Late submission could render all income subject to the proposed Schedule VII rate to be assessed after 12 months in default of a return.

- It is difficult to see why it is thought a tax based penalty is avoided if the company were subject to DPC. The "avoidance method" you suggest of paying a dividend would make the income taxable in the hands of the recipient which overcomes the "money boxing" which you are so eager to prevent. Thus there is no avoidance. This would only arise if the dividend were not declared in the shareholders' own returns. This might render them open to a penalty.

Treasury Response

Notification to the Assessor that a trade has commenced

Treasury has considered the views expressed during the consultation and has concluded that it would not be prudent to bring forward legislation requiring a corporate taxpayer to notify us that it has commenced trade. The Income Tax Division will continue with its current approach whereby a questionnaire is issued after incorporation (usually after about 6 months), the completion of which will inform the Assessor when returns will become due and the nature of income receivable by the company.

Flat rate penalties for late (or non-) submission of returns and habitual late filing
Comments received support the principle of a flat rate penalty for late filing, but concern has been raised about the level of the penalty. Treasury acknowledges the points made and is moving forward with the general structure, i.e. initial default if return not filed by the due date, extended default if not filed by a date 6 months after the due date and increased penalties for habitual late filing. The level of the penalties will be considered further and Treasury will announce a final decision as soon as possible. Further comment on the filing date is included within part 5 below, which may reduce fears expressed regarding the level of penalty proposed.

Tax Based Penalties
A number of views were received concerning the proposed Schedule VII. Treasury feels at this point that an investigation rate of tax will remain useful to combat tax avoidance.

Criminal Offence
The proposal document mirrors the provision introduced in respect of individual returns (Section 111J Income Tax Act 1970) and will extend the time period to two years, during which the taxpayer may be subject to civil penalties for non-submission of returns, but will not be subject to criminal proceedings. The introduction of a civil penalty regime for late filing and the criminal offence for serious cases is seen as a necessary process to ensure that returns are filed within the time limits available.

5. "Pay and file"

Section 5 considered the concept of 'pay and file' for companies. Issues covered included the payment of income tax, interest for late payment, repayment supplement, review period following filing, amendments to returns (by the Division and by the taxpayer), assessments, default assessments and appeals.

Specific comments on this part included:

- The proposed 9 month and 1 day from the end of the accounting period is too short; 12 months is a far more reasonable period. This point was supported by a professional body representing the views of many tax professionals; whilst other contributors indicated that they believed the proposed 9 months to be reasonable.

- Where long periods of account are prepared, please confirm that both returns (for 12 and 6 months – where 18 month accounts prepared) will be required to be submitted by the same date, namely 9 (possibly 12) months after the end of the 18 month period and that the first return is not required 9 months after the end of the first 12 month period.

- Can the filing date be earliest of two dates, one date being 12 months after the end of the accounting period and the second being, say, 24 months after the beginning of the accounting period? This system may allow for one return to be made covering longer periods of account (not two which is proposed by the document), but would ensure that changes of accounting date are not used as a mechanism to delay filing / payment of tax.

- I consider that the proposed reductions in time limits from 6 to 4 years are sensible.

- As you have not advanced any reason for the proposed reduction to 4 years of the existing time limit of 6 years in section 107 it is hard to support.

- The Corporate Tax Working Party envisaged a 'pay and file' system, where after the return was filed, it would be reviewed by the tax authorities and an assessment issued as with the current system. This assessment had exactly the same effect as an assessment under the current system. This gave finality subject to discovery. We have no objection to a self assessment system being introduced, if this is the intention, but it should be called self assessment. The working party never envisaged a self assessment system as at that time, it was felt that this was not the Isle of Man way of doing things.

- In substance what is being proposed is self assessment, rather than pay and file – pay and file would suggest the issuing of an assessment by the Income Tax Division following the submission of a return, which is not the proposal within the document. Therefore I simply suggest that it is acknowledged that the proposed system is a form of self assessment and that is should be described as such.

- Much of the description of how things work in the document is confusing because of the use of the pay and file name and then you try and describe the UK Corporate Tax Self Assessment system.

- The legislation needs to be based on either the pay and file system or the self assessment system. It will be difficult to see a mixture of the two working effectively.

- The reduction in the periods when assessments can be reviewed will have winners and losers. The loss to the taxpayer of 2 years (6years down to 4 years) to have errors corrected will limit some claims that are currently made. However, overall the limit in period of possible adjustment must be a simplification.

- We note your comment that defaults will not be required for companies with 0% rate of tax. With a 10% rate applying to companies with property income, we would query how the Division would know that 0% rate applies to a company. If a company gets a new source of rental income, it will not be a 0% rate company on all its income.

- I am confused by the wording in Para 5.8 – if the Division have not raised an assessment, why would the taxpayer wish to appeal the assessment?

- The proposal not to issue a DPC notice or an assessment seems to omit at least one of section 1(1) (1970) requirement that tax shall be "raised, levied, collected and paid". If the tax liability is to be self assessed, there still must be a formal notification of an agreed amount by a demand for payment or some other sort of account. Notwithstanding this, if an assessment is not to be issued to prompt the payment of any tax due as the return will be due on the same day, any reminder that the return is due should be worded to include reference to payments.

- It is not easy to see how default assessments will work where there are changes to the Scheduled income of a company.

- There is scope for companies to wrongly assess their liability, either over or under, and innocently or otherwise. The Income Tax Division must still assess returns. If companies are liable to be charged interest on underpayment, they may be tempted to overpay and then argue for refund.

Treasury Response

Filing date

Many contributors supported the concept of pay and file, but were concerned that the time limit (nine months and one day after the account period end) was too short. Comment was made regarding the move in the UK from 9 to 12 months. Treasury has considered the position and accepts that payment of tax and filing of the tax return within 12 months of the year end is acceptable. The move to a 12 month system will have an impact on the transition; further comment has been included within part 6 below.

Filing date: Longer periods of account

The question has been raised regarding the submission date for accounts that are for periods greater than 12 months. The proposal document set out the position whereby longer periods of account would be "split", requiring the making of a return covering the first 12 months and a second return covering the second period. Each return would have its own filing date, being 9 months and 1 day after the end of the relevant period; payment of tax would be on the same basis.

For example:

18 month period of account ending on 30 June 2009

First Period: 12 months to 31 December 2008, pay and file date 1 October 2009.
Second Period: 6 months to 30 June 2009, pay and file date 1 April 2010.

(Following Treasury agreement to move the date to 12 months and 1 day, the pay and file dates would be 1 January 2010 and 1 July 2010 for the first and second periods respectively.)

Treasury has reflected on the position, and has concluded that it is not prudent to require two returns and two payments. Equally, Treasury cannot allow companies to delay filing / payment, simply by changing accounting dates. The following method will therefore be adopted:

The payment of tax and the filing date will always be 12 months and 1 day after the end of the accounting period, but where a period of account is longer than 12 months it will be possible to submit one return for the long period.

However, the payment and filing date of the accounting period will remain the same.

Example

Company A has an 18 month accounting period which ends on 30 June 2008.

The return will be due 12 months and 1 day after the end of the first accounting period i.e. 1 January 2009 which is 24 months from the commencement of the period of account. The return for the 18 month period of account is, therefore, due no later than 1 January 2009.

The payment dates for income tax will be 12 months from the end of each of the accounting periods.

12/18 due on 1 January 2009 and 6/18 due 1 July 2010.

Therefore, if a company wishes to change the accounting date to one that is more than 12 months after the commencement of the accounting period it can do so, but the time available for the preparation of accounts, making of a return and the payment of tax will be reduced. In effect, the filing date will be the same as that which would have applied had the length of the accounting period remained the same.

Amendment of Assessments

Treasury notes the support given to the proposal that time limits allowing amendment to assessments be reduced to 4 years from the end of the accounting period. Legislation amending the relevant sections of the Income Tax Act 1970 will be included in the Bill.

Assessments

In 1994 the Corporate Tax Working Party (CTWP) recommended that the assessment should not be required to prompt payment of income tax on the due and payable date, but that an assessment of the agreed liability should continue to be issued until such time as a full self-assessment system could be adopted.

Treasury agreed with that recommendation, but has looked further and questioned the need for an assessment, particularly where there is no liability to income tax for a 0% rate company. Comment has also been made that suggests that there would be confusion if the term "pay and file" is retained, but a system similar to self-assessment is adopted. Again, Treasury notes the concern.

Bringing together the CTWP recommendation and the introduction of a 0% rate for most companies, Treasury has concluded that assessments will not be issued except in the situations set out in the proposal document, e.g. defaults. Where a company files accounts, an acknowledgement will be sent confirming receipt and informing the taxpayer that the 12 month review period has commenced.

6. Transition

This section of the document set out two possible mechanisms for moving to the accounting period basis of assessment for companies. The first, being the method devised in 1994, (when the standard rate of tax for companies was 20%), advanced filing and payment dates steadily, avoiding potential cash flow difficulties where one company is required to pay two amounts of tax during a period that is less than 12 months in duration. The transition would in some cases take five years to complete.

The second method, devised more recently and in recognition of the fact that many companies will be subject to the 0% rate, brings the change to accounting basis into effect after only one year. This method seeks only to charge a proportion of the assessable profit in the transition year.

For example, if the last payment of tax under the current rules falls on 1 January 2008 and the first payment under pay and file falls due on 1 February 2008 (i.e. companies with a 30 April year end), then only one twelfth of the 30 April 2007 profit is charged in the transition. The following period of account ending on 30 April 2008 would result in tax being due and payable on 1 February 2008.

Specific comments on this part included:

- No account has been taken of the loss of the closing year rules. Whilst for a 0% rate company this will not be such a problem, DPC could be affected. Additional tax would be payable for 10% paying companies – loss of closing year rules needs to be recognised during transition.

- Individuals, when moving onto current year basis, had this issue recognised in the form of overlapping profits relief.

- It is not clear from the proposal document what the regime will be for companies that have suffered a double tax charge due to the opening year rule and there appears to be no adequate relief for this situation. Suggestion was made that a company should be able to elect for actual basis of assessment to be used for a period of years leading up to the introduction of the new corporate tax regime; the writer suggested that period could be up to 10 years.

- The one year transition seems reasonable. However we believe companies subject to DPC will see over-complication; the proposal introduces 365 different credit rates for the DPC credit given to shareholders. Can we suggest that using the example in para 8.1.1 that the drop out profits of £70,000 is treated in the same was as profits earned prior to DPC introduction and the credit rate is left as 9.9% or 18% on the £50,000.

- I consider that the "New Proposal" set out for transition for companies that are already on a concessional PY accounts basis to a proper accounting period basis of assessment is the preferred option.

- A long term transition may cause more trouble than it saves. A short accounting year would seem preferable to a series of shorter ones or long accounting periods.

- The idea suggested in the proposal document is that a 30 April year end would result in a certain amount of tax effectively being waived by Treasury. This appears extraordinary and is not equitable. Companies with a 30 April year end have already enjoyed paying tax far later than other companies and if they are let off paying some tax then a similar tax waiver must occur for all companies. Surely Government cannot be seen to subsidise companies with a 30 April year end at the expense of other companies. A solution is that either tax is waived

for all companies or the transition period for 30 April year end companies does not involve a tax waiver.

Treasury Response

Transition

It is important that the move to the new basis of assessment should not be at a cost to the revenue and, therefore, another option for transition is being proposed. Also, Treasury's acceptance of moving the payment date to 12 months after the end of the year of assessment reduces the impact of transition for many companies.

Treasury notes the support for the new mechanism that would result in a one year transition and has, therefore, based this proposal on that.

The new proposal will allow for a delay in the payment of income tax rather than a taper relief, depending on how much the payment date is accelerated. The total liability in the year of transition will, therefore, be paid no later than 1 January, which is the existing payable date for companies. The payment date then moves to 12 months and 1 day after the accounting date in the subsequent year.

An amended table has been included in appendix A of this document to identify those year ends that will have a delay in payment for the transitional year.

For example, a company with an accounting period ending on 30 April will pay income tax as follows:

The profit for the year ended 30 April 2006 will, under the old rules, form the basis of the 2007/8 tax assessment due and payable on 1 January 2008.

The profit for the year ended 30 April 2007 will, under the new rules, lead to tax due and payable 12 months and 1 day after the end of the accounting period, i.e. 1 May 2008.

As the company has two income tax payments within the same year it is proposed that only 4/12ths of the liability will be due on 1 May 2008. The remaining 8/12ths will be due and payable on 1 January 2009.

This deferral will only apply in the transitional year.

Opening Year Rules

Some companies, as a result of commencement rules, paid income tax twice on a proportion of the profits arising in the first years of business. The move to a current year basis of assessment for individuals carried a transitional relief reflecting the loss of closing year rules that would have countered the effect of the opening year rules.

Those trading companies that have paid tax twice on profits during opening years, are enjoying the benefits of reduced tax rates – soon to be reduced to 0% – whilst self-employed individuals have continued to be charged at rates of up to 18%. Treasury has concluded that it is not appropriate to allow overlap relief for corporate taxpayers.

New Commencements on or after 6 April 2004

The consultation document identified at paragraph 7.2 a potential solution for companies that commenced on or after 6 April 2004 and provided a number of examples showing how these companies would be assessed during the transition. There were no significant comments relating to the proposal and Treasury is now satisfied that the transition outlined in the document is appropriate. Companies that commenced on or after 6 April 2004 will be assessed in accordance with the examples shown.

7. Other issues

Section 8 of the proposal document considered the situation where a 0% rate company is in receipt of foreign taxed income and distributions are made by that company. In the past, the company would have been able to claim double taxation relief through the assessment and, subject to other conditions being satisfied, clearance for capital distribution of the profits, thereby minimising (or removing) effective double taxation of the income.

A new system was proposed that would provide for capital distribution (subject to clearance) where the income had been received by the company net of foreign tax, but only where that tax was at a rate that was greater than, or equal to, the 18% higher rate of tax. Where foreign tax was suffered at a rate that was less than 18%, the distribution would be taxable in the hands of the recipient, subject to relief that was equal to the tax suffered by the company.

It was further proposed that the profit subject to DPC would be reduced by the amount of the tax, where the foreign tax was suffered at a rate less than 18%, and that the DPC would be avoided altogether where the rate was greater than 18%.

Specific comments on this part included:

- The differential between the treatment of income which has suffered tax at 18% and income which has suffered tax at 17.99% is very harsh; (an example was provided that supported the argument).

- Credit relief should apply in all cases.

- Para 8.2.3 proposes an expense relief approach for double taxation relief for the purposes of calculating the DPC where the rate of tax is less than 18%. I consider that credit relief should be granted, or else the position will be worse than under the current tax regime in certain situations.

- When a company operates in other tax jurisdictions, that jurisdiction has the right to tax as it sees fits. This should be treated as a legitimate expense for accounting purposes within this jurisdiction.

Treasury Response

Double tax relief will remain in its current form for income tax, however due to the reduction to a 0% rate, the majority of companies will be unable to claim relief as their income tax liability will already be nil.

The treatment of taxed foreign income for DPC purposes has been documented within the DPC Guide. For foreign income subject to less than 18% tax, the amount of tax paid will be deducted from the "distributable profit" (to be known as expense relief).

Treasury originally considered a system where foreign income would attract a tax credit which would pass on to the recipient of a distribution. However, very few companies actually receive foreign income which has suffered tax at a rate of less than 18% and Treasury does not consider that the additional administration burden and complexities of such a system are merited.

Appendix A

Transitional provisions for Corporate Clients on PY Basis of Assessment for 12 month Accounts ending between 6 April 2006 and 5 April 2007

Accounts ending after 5 April 2007 will fall into the corporate tax regime and will be assessed on an accounting period basis.

Blue shaded column represents the due and payable date for the final periods of account assessed on PY basis.

Lilac shaded dates represent end of transition and commencement of strict 12 month and 1 day due and payable date.

Dates in bold represent transitional "deferred" payment dates, and the relevant fractions payable on that date are shown in italics below.

Accounting period end	2006	2007		2008
31 January	1.1.07	1.1.08		1.02.09
28 or 29 February	1.1.07	1.1.08		1.03.09
31 March	1.1.07	1.1.08		1.4.09
30 April	1.1.08	**1.5.08**	**1.1.09**	1.5.09
		4/12	*8/12*	
31 May	1.1.08	**1.6.08**	**1.1.09**	1.6.09
		5/12	*7/12*	
30 June	1.1.08	**1.7.08**	**1.1.09**	1.7.09
		6/12	*6/12*	
31 July	1.1.08	**1.8.08**	**1.1.09**	1.8.09
		7/12	*5/12*	
31 August	1.1.08	**1.9.08**	**1.1.09**	1.9.09
		8/12	*4/12*	
30 September	1.1.08	**1.10.08**	**1.1.09**	1.10.09
		9/12	*3/12*	
31 October	1.1.08	**1.11.08**	**1.1.09**	1.11.09
		10/12	*2/12*	
30 November	1.1.08	**1.12.08**	**1.1.09**	1.12.09
		11/12	*1/12*	
31 December	1.1.08	1.1.09		1.1.10