CHAPTER 31

ACCOUNTING FOR INCOME TAX

31.1 Income tax withheld

When companies make certain payments, such as annual interest on debentures/loan stock or patent royalties to individuals or certain overseas companies, they are required to **deduct income tax at source.** ITA 2007, s.874

The tax deducted settles the income tax liability of the recipient, not of the company paying it – ITA 2007, s.874.

Tax is deducted at the following rates: ITA 2007, s.874(2)

Interest	20%
Royalties	20%

ITA 2007, s.901(4)

Illustration 1

A company agrees to pay the following to individuals:

Interest on £1 million worth of 10% debentures
Patent royalties of £50,000 per annum

Payments will be made as follows:

80% of the interest will be paid to the recipient and 20% will be deducted at source and paid to HMRC. The total interest payable is £1m x 10% = £100,000, of which £80,000 will be paid to the recipient and £20,000 will be paid to HMRC.

80% of the patent royalty will be due to the recipient and 20% must be withheld by the company and paid to HMRC. The total royalty payable is £50,000, of which £40,000 will be paid to the recipient and £10,000 will be paid to HMRC.

31.2 Income tax suffered

Companies do not suffer income tax on amounts received from other UK companies and conversely they do not withhold tax on payments to other UK companies.

However, if companies receive patent royalties **from individuals** they are deemed to have received the income **net of 20% income tax**. ITA 2007 s.903

Interest and royalty payments by a UK company to **an EU associate** can be made **gross**. In the case of **interest payments, an exemption certificate** is required. The rules cover payments to EU companies or permanent establishments. The term "associate" for these purposes requires a **25% interest.** ITTOIA 2005, s.758

If a company is deemed to have suffered income tax it is claimed against its corporation tax liability as follows:

	£
Corporation tax liability	X
Less: IT suffered on "taxed income"	(X)
Corporation tax due	X

Note that this process is similar to the way that individuals receive credit for income tax deducted at source in their personal tax computation – i.e. gross income is charged to tax then any tax suffered at source on that income is deducted at the bottom of the computation.

31.3 Quarterly Accounting

Companies must account for income tax on a quarterly basis, using a CT61 quarterly return, based on amounts paid and received in the particular quarter.

The quarters are the same as the normal calendar quarters of the year, i.e. **31 March, 30 June, 30 September** and **31 December**. If a company's **year end is different from any of these, there will be 5 return periods**.

For example, a company with a year ended 31 May will have the following return periods:

1 June	to	30 June
1 July	to	30 September
1 October	to	31 December
1 January	to	31 March
1 April	to	31 May

The tax is due 14 days following the end of the return period.

Illustration 2

Buckingham Ltd pays and receives the following amounts during the year ended 30 June 2011. All amounts shown are actual amounts paid or received.

		£
1.8.10	Interest paid to Mr Salisbury	144,000
1.11.10	Patent royalty received from Mr Wells	195,000
30.11.10	Interest received from UK company	45,000
1.12.10	Patent royalty paid to Mr Bath	39,000
1.2.11	Interest paid to Mr Salisbury	144,000
1.5.11	Patent royalty received from Mr Wells	195,000

The income tax paid during the quarters is calculated as follows:

	Tax Withheld	*Tax Suffered*	*Net*	*Tax Due/ (Repayable)*	*Due Date*
	£	£	£	£	
Q/e 30.9.10					
1.8.09 (W1)	36,000		36,000	36,000	14.10.10
Q/e 31.12.10					
1.11.10 (W2)		(48,750)	(48,750)		
30.11.10 (W3)		Nil			
1.12.10 (W4)	9,750		9,750		
			(39,000)		
			36,000	(36,000)*	
C/fwd			(3,000)		
Q/e 31.3.11					
1.2.11 (W1)	36,000		36,000		
			33,000	33,000	14.4.11
Q/e 30.6.11					
1.5.11 (W2)		(48,750)	(48,750)		
			33,000	(33,000)*	
			(15,750)		

*Any refund of income tax during the accounting period is restricted to the cumulative amount the company has already paid HMRC up to that point in the accounting period.

Any excess of income tax suffered at the end of the accounting period (in this case £15,750) is deducted from corporation tax due on the normal due date; i.e.

	£
Corporation tax liability	X
Less: income tax suffered	(15,750)
Corporation tax due	X

Workings:

W1: Interest to individual = paid net of 20% tax

$$£144,000 \times \frac{20}{80} = £36,000$$

W2: Patent royalty from individual = received net of 20% tax

$$£195,000 \times \frac{20}{80} = £48,750$$

W3: Interest from UK company = received gross

W4: Patent royalty to individual = paid net of 20% tax

$£39,000 \times \frac{20}{80} = £9,750$

Example 1

Blenheim Ltd pays interest on its £2m 10% debentures every 6 months on 1 January and 1 July.

25% of its debentures are held by UK resident companies.

It received £65,000 in patent royalties from another UK company on 1 May 2010.

The company has a 30 September year end.

You are required to calculate the total tax withheld in the year ended 30 September 2010.

31.4 Summary

For each CT61 quarter the tax withheld from payments made net (i.e. tax to be paid over to HMRC) is compared with the tax suffered on receipts received net (i.e. tax which can be reclaimed from HMRC).

If the tax withheld exceeds the tax suffered, the net amount is the amount of tax the company must pay over to HMRC for that quarter.

If the tax suffered by the company exceeds the tax withheld, a refund of tax is required from HMRC for that quarter. However, HMRC will not repay more than the amount of tax that the company has already paid over so far in the accounting period.

Any excess tax suffered is carried forward to a later quarter and deducted from the next payment due. If, by the end of the accounting period the full amount of tax suffered has not been repaid, it is deducted from the company's CT liability. If the income tax suffered exceeds the CT liability for the period, any balance will be repaid by HMRC.

	£
Corporation tax liability	X
Less: income tax suffered in the period and not yet repaid	(X)
Corporation tax due	X

HMRC published a consultation document on 5 March 2010 with regard to "Changes to the tax rules on the deduction of Income Tax at source". The document outlines various proposed administrative changes to the CT61 system, including a possible move to online filing, and annual reporting. Comments were to be submitted by 28 May 2010.

Answer 1

Payments on which income tax to be withheld:	£
1.1.10: £2,000,000 x 75% x 10% x $\frac{1}{2}$	75,000
1.7.10: £2,000,000 x 75% x 10% x $\frac{1}{2}$	75,000
	£150,000

	£
Tax withheld £150,000 x 20%	30,000
Tax suffered (royalties received from another UK company)	Nil
Net tax withheld	**£30,000**