



TAX

INTRODUCTION

The UK's attractive pro-business tax regime within the European Union makes it one of the most inviting and profitable locations for investors. In the UK all businesses regardless of size, benefit from very reasonable rates of tax on their profits. This is known as corporation tax. The Government is committed to helping small and medium-sized enterprises (SMEs)¹ by implementing tax-related measures that:

- reduce the regulatory burden
- improve their cash flow
- enable them to offer better incentives to their employees
- make it easier for them to raise finances

The UK has the most extensive network of double taxation treaties in the world. These aim to stop income being taxed twice when it crosses a border. The UK has no exchange controls to prevent profits from being paid overseas

TAX LIABILITY

If a company is a UK resident, it will have to pay corporation tax on its worldwide profits, adjusted for tax purposes. This includes capital gains tax (CGT) on profits from the sale of assets. A company will qualify as a UK resident if it is incorporated in the UK or its central management and controls are in the UK. Any foreign income on which a company pays tax abroad is still liable to tax in the UK. However, the overseas tax paid can generally be credited against the companies, tax bill.

Other EU countries have lower rates of corporate tax, but it is the total levels of taxation that companies consider before

¹ EU definition of a small and medium-sized enterprise is that it must have a maximum of 249 employees and maximum of 25 per cent ownership by one, or jointly by several individuals. In addition, the company must have either a maximum annual turnover of 40 million euros or a maximum annual balance sheet total of 27 million euros.

making a mobile investment decision. The UK remains the lowest-taxed large economy in the EU, with advantages including:

- the UK has among the lowest main corporate tax rates in the EU;
- low personal taxes plus low social welfare contributions;
- there are generous tax allowances and no local taxes on profits or surpluses.

TAX RATES

Table 1 shows that the UK's main corporate tax rate is both competitive in Europe and worldwide.

The standard rate of corporation tax is 30 per cent and applies equally to both resident and non-resident companies.

Table 1: Corporate tax rates 2002/2003, international comparison table

Country	Corporate Tax Rate
Japan	42%
US	40%
Germany	39.58%
Italy	38.25%
Canada	36.6%
Spain	35%
Netherlands	29/ 34.5%
France	34.33%
Austria	34%
Belgium	33.99%
China	33%
Luxembourg	30.38%
UK	30%
Sweden	28%
Ireland	12.5%

Source: KPMG Corporate Tax Rate Survey, 2003

The above rates do not reflect payroll taxes, social security taxes, net wealth taxes, turnover/sales taxes and other taxes not levied on income.

The rates of corporation tax for a single company are highlighted in Table 2. The starting rate of zero applies to

taxable profits below £10,000 on the income of resident companies in the UK. Marginal relief is available to companies with profits from £10,001 to £50,000. The rate for small companies is 19 per cent for profits from £50,001 to £300,000.

Table 2: UK corporation tax, financial years 2003/04

Starting rate zero	0–10,000
Marginal relief	10,001–50,000
Small companies' rate 19%	50,001–300,000
Marginal relief	300,001–1,500,000
Main rate 30%	1,500,001 or more

Source: Inland Revenue, 2003

If a company sets up a branch of an overseas company in the UK, the trading profits of the branch's activities in the UK will be liable to tax. The rate applied will usually be 30 per cent, but may be reduced for a company that is part of a group or has associated companies.

The lower rates and marginal reliefs do not apply to close investment holding companies.

PERSONAL TAXATION

If you become resident in the UK, you will normally have to pay UK tax on all worldwide income. You will qualify as a resident if:

- you spend 183 days or more in the UK in any tax year (the tax year runs from 6 April to 5 April); or
- there is intention to stay in the UK at least two years; or
- there are regular visits to the UK, averaging at least 91 days per tax year over a maximum of four years.

If you are a resident but not domiciled in the UK, you will only have to pay tax on your overseas income if you bring it into the UK. The exception is income arising in the Irish Republic, which is taxable regardless of whether you bring it into the UK.

If you are not a resident in the UK, you will only have to pay UK tax on your UK income.

All UK residents are entitled to the “basic personal allowance”. This is an amount of income on which you do not have to pay any tax. For 2003/2004, it is £4,615. Other reliefs and allowances may be available, depending on individual circumstances.

For income tax above the level of the personal allowance, see table 3 for the 2003/2004 tax year standards.

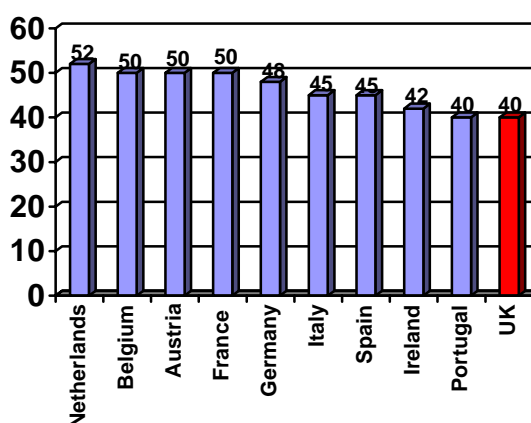
Table 3: Taxable bands 2003/2004

Starting rate 10%	0-1,960
Basic Rate 22%	1,961–30,500
Higher Rate 40%	Over 30,500

Source: Inland Revenue, 2003

The higher tax band, at 40 per cent, is one of the lowest in the EU, see Figure 1

Figure 1: EU Personal Tax (higher) Rates 2003



Source: Inland Revenue

CAPITAL GAINS TAX

Capital gains tax (CGT) is a tax on capital gains. You may have to pay CGT if you dispose of an asset, or receive a sum of money in respect of an asset.

You only have to pay CGT on disposing of an asset if you have made a chargeable gain. Typically, you make a gain if the asset is worth more than it was when you acquired it.

The amount of CGT is based on the gains that you make on disposals of assets and capital sums that you receive from assets in the tax year. The tax year ends on 5 April.

Most sorts of assets can lead to a CGT charge when you dispose of them, for example shares in a company, land and buildings, higher value jewellery, paintings, antiques and other personal effects.

Individuals are exempt from CGT on the first £7,900 for the tax year 2003/04 of profits made (in any one year) from the sale of an asset.

The rate of CGT you will have to pay depends on the level of your income liable to income tax. The amount chargeable to CGT is added on to the top of your income liable to income tax and is charged at the appropriate rates. For the tax year 2002/003, the rates are 10 per cent, 20 per cent and 40 per cent. You may qualify for reliefs that reduce or defer your chargeable gains.

EMPLOYER'S SOCIAL SECURITY COSTS

Employers pay less social security contributions in the UK than in most other European countries.

Employers have to make social security contributions in respect of every employee whose earnings exceed a specified earnings threshold.

The pay as you earn (PAYE) thresholds (level of earnings at which tax becomes payable) are:

- £89.00 weekly
- £385.00 monthly

These are the same as the earnings thresholds for National Insurance contributions (NICs). The tax rates are as shown in Table 3.

To calculate NICs three levels of earnings are used:

- lower earnings limit (LEL)
- earnings threshold (ET) and
- upper earnings limit (UEL)

Lower earnings limit (LEL)

This is the minimum level of earnings that an employee needs to qualify for benefits. If an employee's earnings reach or exceed this level, but do not exceed the earnings threshold, they will not pay NICs but will be treated as having paid contributions when claiming benefit.

Earnings threshold (ET)

When the earnings exceed this level NICs become payable by the employee and employer. This is set at the same level as the PAYE threshold.

Upper earnings limit (UEL)

Where earnings exceed the UEL, the employee pays NICs at 1 per cent on those earnings above the UEL. The UEL does not apply to the employer's NICs, which are payable on all earnings above the ET, including those above the UEL, at the appropriate rate.

For further information on PAYE contact the Inland Revenue at:

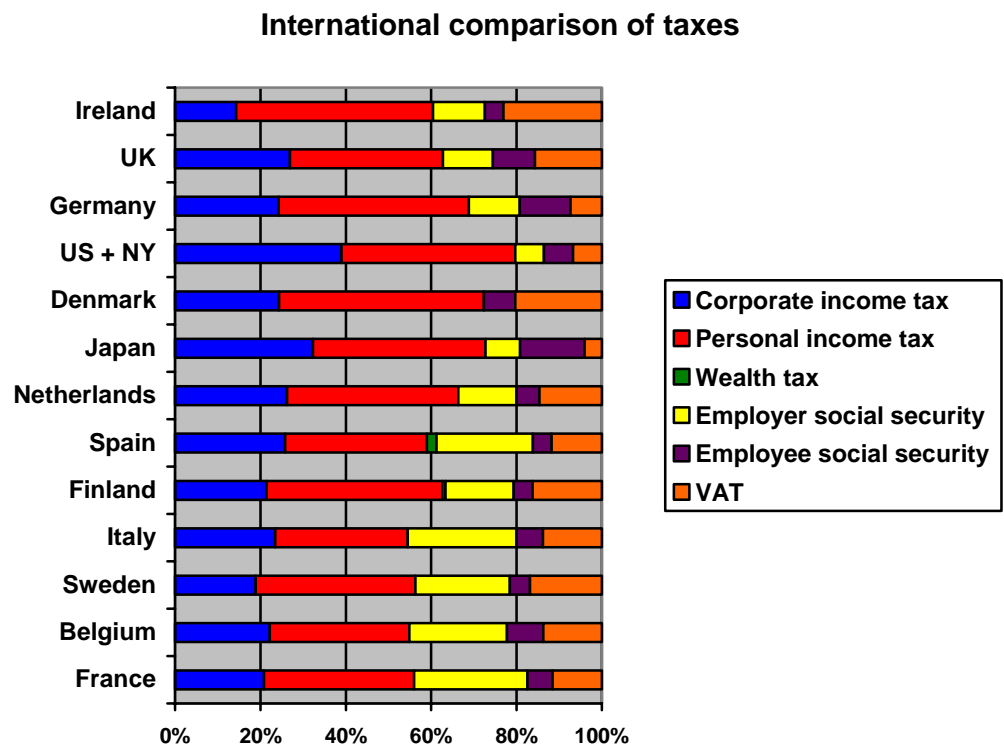
www.inlandrevenue.gov.uk/employers/rates_and_limits.htm

The current UK total social security contribution is 23.8 per cent, this includes employer (12.8 per cent) and employee (11 per cent) contributions.

From April 2003 all employees pay National Insurance contributions on that part of their earnings which falls between £89.01 and £585 per week at a rate of 11 per cent, whilst those who are paid more than £585 per week will pay NICs at 1 per cent on all earnings above that figure, with no upper limit. The rate for the employer's NICs on earnings, with no upper limit is 12.8 per cent.

This level of social security contribution is extremely competitive compared to the UK's key European competitors. Figure 2 shows that only Ireland has lower total levels of social security contributions. Employees in the UK have a larger percentage of their salary left after tax deductions than in most other EU countries.

Figure 2: International comparisons of taxes



Source: Ernst and Young GemS/Forbes Global – May 2003

VALUE ADDED TAX

Value added tax (VAT) is due on supplies of goods and services (other than exempt supplies) which are made in the UK in the course of furtherance of business, by a taxable person who is registered or is required to be registered for VAT, and also on the importation and acquisition of goods and some services.

VAT is a charge you will need to make to your customer if:

- you supply goods or services in the UK or Isle of Man;
- your taxable turnover is above the registration threshold, which is currently £56,000.

The VAT you charge your customers is known as output tax. Once you register for VAT you will be able to claim back any VAT charged to you on business-related goods or services. The VAT you pay your supplier is known as input tax.

Goods and services that are VAT-rated are called taxable supplies. The total value of your taxable supplies is your taxable turnover. You will need to register for VAT if:

- at the end of the month, your taxable turnover has exceeded £56,000 in the past 12 months or less;
- at any time you expect the value of your taxable supplies to exceed £56,000 in the next 30 days alone.

There are three rates of VAT:

- the standard rate (17.5%) – applies to most goods;
- the reduced rate (5%) – applies to fuel and power used in the home and by charities;
- The zero rate (0%) – applies to a limited range of goods and services including most food, books, newspapers and young children's clothing.

Some business supplies are not subject to VAT at all. These exempt supplies do not form part of taxable turnover. Examples include:

- selling, leasing and letting land and buildings (but not lettings of garages, parking spaces or hotel and holiday accommodation);
- insurance;
- betting, gambling and lotteries providing credit;
- certain education and training;
- fundraising events by charities;
- subscriptions to certain membership organisations;
- the services of doctors and dentists.

If taxable turnover is below the registration threshold, an application can be made for voluntary registration.

Further help and advice on all aspects of VAT is available at the HM Customs and Excise website:

www.hmce.gov.uk

RESEARCH AND DEVELOPMENT

An R&D tax credit for companies which are small and medium-sized enterprises (SMEs) was introduced in 2000.

The credit has been established to assist SMEs to undertake R&D, either for the first time, or to encourage them to increase their R&D effort. Guidelines have been published by the UK Government which outline what constitutes R&D for tax purposes.

Spending on qualifying R&D attracts relief for 150 per cent of the expenditure. This will reduce the cash cost by 28.5 per cent for a company benefiting from the small company rate of corporation tax (19 per cent).

Companies not yet making a profit can take the relief up front and reduce their cash cost by 24 per cent.

In the 2002 Budget, the Government announced the introduction of a new tax relief to encourage R&D and innovation in the UK by large companies. It applies to all qualifying R&D expenditure from 1 April 2002.

Large companies are entitled to an additional deduction from their taxable income of 25 per cent of their current spending on qualifying R&D, in addition to the normal 100 per cent deduction.

For example, if a company spends £100,000 on qualifying R&D it will be able to deduct £100,000 from its taxable income under ordinary tax rules and an additional £25,000 under the R&D tax credit. For a company paying the main rate of corporation tax at 30 per cent the credit would therefore give a reduction in tax of £7,500.

Guidelines on the “Meaning of Research and Development for Tax Purposes” are available on the internet at: http://www.dti.gov.uk/support/taxcredit_b.htm

TAXATION OF UK BRANCHES OF FOREIGN COMPANIES

In 2003 the Government announced changes to the taxation of mainly foreign companies operating in the UK through a branch rather than a subsidiary. These measures affect the way taxable profits for the branch are measured and they are likely to impact most significantly on the banking sector. The new rules ensure:

–a branch will be treated as having the amount of equity and other capital that it would need as if it were a separate company operating in the UK;

the modernisation of the terminology used in UK domestic tax legislation, changing the taxation of “branches” to the taxation of “permanent establishments” which is more commonly used in UK double taxation agreements.

For more information visit the Inland Revenue website at : www.inlandrevenue.gov.uk/pbr2002/tax_foreign_co.htm

TRANSFER PRICING

Transfer pricing concerns the terms that connected parties use when they conduct business with each other.

The UK requires cross-border trading and financial transactions between affiliated entities to be conducted according to the arm’s length standard. This means that the terms and pricing of such transactions undertaken in the course of conducting business (such as the sale and purchase of goods and services) and in the provision of finance (both borrowing and lending), should be the same as if the transactions had been between completely independent parties.

In determining what is the arm’s length price, the Organisation for Economic Co-operation and Development transfer pricing guidelines are applied. Companies must maintain sufficient documentation to support the prices used and any adjustments made.

TAX TREATIES

The UK network of treaties is amongst the biggest in the world. It has concluded a number of treaties for the avoidance of double taxation. An important feature of most treaties is a reduced or zero rate of withholding tax on the payment of dividends, interest and royalties. For example, on 31 March 2003 the US exchanged the instrument of ratification with the UK with respect to the new US-UK Income Tax Convention.

APPROVED AND TAX FAVOURED SHARE PLANS

The UK Government actively supports small companies, entrepreneurs and an innovative business environment by allowing the granting of employee share plans: -

Approved Plans

Company Share Option Plans (CSOP) - These are discretionary schemes where the company can select the employees and directors it wishes to reward. The company grants them an option to purchase the company's shares at today's price. No participant can be granted approved options with a value of more than £30,000 calculated at the date of grant.

Savings Related Option Scheme (SAYE) -. The company can specify a qualifying period of up to 5 years employment for employees to be eligible to participate. The company grants employees options to buy the company's shares in 3, 5 or 7 years time at today's price or at a discount of up to 20% of that price. Participants must enter into a special savings contract to buy the shares at the end of a fixed term The monthly savings must be between £5 and £250. Payments under the savings contract must be made on a weekly or monthly basis from salary or wages

Companies can only operate the above schemes with Inland Revenue approval. Provided all requirements are met, no income tax or NIC charge arises on awards made under CSOP or SAYE.

Share Incentive Plan (SIP) - Under a SIP an employer can give all employees awards of free shares (which can be

performance related) up to a maximum of £3,000 of shares per tax year. An employee may buy partnership shares from pre-tax salary, up to maximum of £1,500 per tax year. The employer may, at its discretion, match these partnerships shares 2:1. Finally, £1,500 per year of dividends paid out on an employee's shares held under the plan can be re-invested tax free in further shares for the employees. Provided the requirements are met in full, any gains arising while the shares are held in the plan will be free of NIC, income tax and CGT.

Enterprise Managed Incentive (EIM) is not an approved plan but it does benefit from a favourable tax status where certain conditions are met. EIM is available to qualifying trading companies with gross assets of £30 million or less. Employees may each receive options over shares worth up to £100,000 at the date of grant. This is subject to an overall financial limit of £3million on the total market value of shares (at the date of grant) that may be under EMI options at any time. Where EMI options are granted at or above market value there is no income tax or NIC at grant or exercise (provided all the relevant conditions are met).

Further details on employee share plans are available at:

http://www.inlandrevenue.gov.uk/shareschemes/a_z_index.htm

FURTHER INFORMATION

For further information about taxation and national insurance matters in the UK see the Inland Revenue website at:

<http://www.inlandrevenue.gov.uk/>

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