

Chapter 16

CORPORATION TAX

1 Introduction

1.1 Scope of corporation tax

Companies resident in the UK are chargeable to corporation tax on worldwide income and gains.

A company is UK resident if it is either,

- (a) Incorporated in UK eg A Ltd or V plc, or
- (b) Centrally managed and controlled from UK eg A Inc., which is incorporated overseas, but the majority of its directors are resident in UK and board meetings are held in UK.

1.2 Definitions

- A **period of account** is the period for which a company prepares its accounts. Usually a company will prepare accounts for a period of 12 months, but a period of account may be for a shorter or longer period than this. This may occur when a company either commences or ceases trading, or whenever it changes its accounting date.
- Corporation tax is charged in respect of **accounting periods**. Normally a company's accounting period (AP) will be the same as its period of account but it CANNOT EXCEED 12 months.
- This is the period for which the Corporation Tax computation is prepared and for which the Taxable Total Profit (TTP) is computed. If the period of account exceeds 12 months then 2 corporation tax computations will be required, the first for 12 months and the second for the remainder of the period (see chapter 17)
- The tax rates to be used however, are set for **Financial Years** (FY) which run from April 1 to following March 31 and are denoted by reference to the year in which they start, hence:

FY 2021 = 1 April 2021 to 31 March 2022, and

FY 2020 = 1 April 2020 to 31 March 2021

For FY 2021, FY 2020 and FY 2019 the rate of corporation tax is 19%.

A company usually has to pay its CT liability 9 months and 1 day after the end of its AP, but large companies are required to make quarterly instalment payments to settle their corporation tax liability.

A large company is a company whose "profits" exceed £1.5M.

"Profits" are defined as the TTP of the company plus dividends received (excluding dividends from related 51% group companies).

Companies are related 51% group companies where one company controls another or two or more companies are both 51% subsidiaries of another company. Dormant companies are excluded.

The limit of £1.5M is used for a single company with a 12 month AP. It is therefore divided by the number of related 51% group companies at the end of the immediately preceding accounting period and must also be time apportioned for an AP of less than 12 months.

ILLUSTRATION 1

Large Ltd prepares its accounts to 31 March in each year and for the accounting year ended 31 March 2022 it had a TTP of £600,000 and also received dividends from a number of companies including its two wholly owned subsidiary companies. This was its lowest profit recorded in several years.

As Large Ltd has two subsidiary companies there are three related 51% group companies which will reduce the profit limit for each group company to £500,000 (£1.5M / 3). As Large Ltd has a TTP of £600,000 then even without including dividend income its "profits" exceed the relevant profit limit and it will therefore be required to make quarterly instalment payments to settle its CT liability for the accounting period. See chapter 23 for details of the quarterly instalment payment system.

1.3 Accounting periods

- An AP will normally start immediately after the end of the preceding AP.
- An AP will also start when a company commences to trade, or when its profits otherwise become liable to corporation tax.
- An AP will normally finish twelve months after the beginning of the period or at the end of a company's period of account.
- An AP will also finish when a company ceases to trade, or when its profits otherwise cease being liable to corporation tax.

2 Taxable Total Profits (TTP)

A company's corporation tax liability for an accounting period is calculated by computing profits (income + gains) from all sources and deducting qualifying charitable donations. This figure is known as Taxable Total Profits (TTP) and is then charged to tax at the relevant corporation tax rate of 19%.

Pro forma corporation tax computation

Corporation Tax Computation for the year ended 31 March 2022

	£	£
<i>Trading income</i>		
Adjusted profit	X	
Less: Capital allowances	(X)	
Tax Adjusted Trading Profit		X
<i>Other income & gains</i>		
Interest receivable		X
Property Income		X
Net chargeable gains		X
Total Profits		X
Less: Qualifying Charitable Donations		(X)
Taxable Total Profits		X

2.1 Notes

- Dividends received from other UK and overseas companies are not taxable, dividends paid are not deductible.
- Companies pay corporation tax (not capital gains tax) on chargeable gains (see chapter 19)

3 Royalties payable

Relief for royalties payable is given in line with the accounting treatment, and therefore royalties payable are allowed as a deduction when calculating the adjusted trading profit. No adjustment is therefore required.

4 Royalties receivable

The taxation of royalties receivable will follow the accounting treatment on an accruals basis. Royalties receivable will therefore be included in the adjusted trading profit, with no adjustment being required.

5 Tax Adjusted Trading Profit

5.1 This calculation is similar to unincorporated business:

Adjusted profit	X
less Capital Allowances	<u>(X)</u>
Tax adjusted trading profit	X

5.2 Adjusted profit

The rules discussed in chapter 4 for unincorporated business are similar for incorporated businesses and should now be revised. The main differences in the adjustment of profit in corporation tax are:

- (a) No private element of expenses added back as no proprietor
- (b) Drawings (cash or goods) is not relevant for companies as no proprietor. Any salaries or benefits provided to business owners who work in the company are assessed as employment income on the individual and will be allowable deductions for the company. Any distributions (dividends paid to shareholders) are not allowable deductions and are paid out of post tax profit
- (c) Family salaries are not relevant for companies
- (d) Legal fees regarding the issue of share capital are an expense only for companies and as they are of a capital nature, the expense is disallowed and added back in the adjustment of trading profit
- (e) Legal fees with regard to registering patents and trademarks are allowable by statute
- (f) Interest payable on a non-trading loans are added back, but the expense is deductible instead against interest income
- (g) Interest payable to HMRC is treated as non-trading but is also tax relievable against interest income (interest receivable from HMRC is taxable as interest income)

5.3 Capital allowances

The basic capital allowance rules for an unincorporated business, (see chapter 5) have previously always applied to companies with the exception that there are NO private use assets and note only one AIA is allowable to a group of companies.

For a two-year period from 1 April 2021 to 31 March 2023 however, companies can benefit from enhanced capital allowances when they purchase NEW plant and machinery:

For expenditure that would fall into the main pool and otherwise attract the AIA, there is a 130% (super deduction) FYA that is instead now available. This means that for every £100,000 of expenditure, a first year allowance of £130,000 is available. It is however ONLY expenditure on new plant and machinery that qualifies, NOT expenditure on second-hand assets. In addition motor cars do not qualify but as per the rules in income tax for unincorporated traders, zero emission cars will attract the usual 100% FYA.

For expenditure which would fall into the special rate pool, there is a 50% first year allowance.

The effect of this is that special rate pool expenditure should firstly attract AIA as the 100% AIA is better than the 50% FYA - if such expenditure exceeds the AIA limit (£1m for a 12 month accounting period) then the excess will be eligible for the 50% FYA with the remaining 50% being allocated to the special rate pool where the reduced rate of WDA (6%) will become available from the NEXT accounting period onwards.

Second hand plant and machinery which is of course NOT eligible for the 130% FYA, will continue to be eligible for AIA.

For qualifying expenditure otherwise falling into the main pool, the 130% super deduction FYA should be claimed rather than the 100% annual investment allowance.

Disposals of assets that attracted these enhanced capital allowances have special rules that apply but these will not be examined in the TX-UK examinations.

ILLUSTRATION 1

Invest Ltd has an accounting reference date of 31 March each year. On 1 April 2021, the tax written down value of plant and machinery in the company's main pool was £100,000 and special rate pool is £0.

During the year ended 31 March 2022, Invest Ltd purchased new plant and machinery costing £300,000 and new long life assets at a cost £1,400,000.

Compute Invest Ltd's capital allowance claim for the year ended 31 March 2022.

	£
Main pool (100,000 @ 18%)	18,000
130% FYA (300,000 @ 130%)	390,000
Special rate pool - AIA (max £1m)	
- AIA (max £1m)	1,000,000
- 50% FYA (1,400,000 - 1,000,000) @ 50%	200,000
Capital Allowances claim	1,608,000

The remaining special rate pool expenditure of £200,000 will attract the 6% WDA from the next accounting period

5.4 Basis periods

The complicated rules for unincorporated traders are not relevant for companies. Tax adjusted trading profit is calculated for an AP and included with other income and gains to arrive at Taxable Total Profits. The tax is then calculated for the AP.

6 Property Income

6.1 As per individuals (see chapter 3) with some notable exceptions

- (a) The property income is always calculated on an accruals basis for the AP
- (b) Interest payable on a loan to buy a rental property is fully deductible against interest income not property income under the non trading loan relationship rules. The restriction that applies to individuals on finance expense does not apply in corporate tax.
- (c) There is no rent a room relief for companies
- (d) If a company makes a property business loss on its properties it must be offset in full against total profits before deduction of qualifying charitable donations of the current period - any unused donations paid are wasted. Any excess property business loss is carried forward and set off against any part of the total profits of the company - partial claims may be made and therefore avoid wasting any donations paid.

7 Interest income

- (a) All interest receivable is assessed as interest income on an accruals basis
- (b) Companies receive all interest gross.
- (c) Interest payable is deductible against tax adjusted trading profit if loan used for trading purposes eg to acquire property or plant & machinery to use in the trade, or to increase working capital.
- (d) If the loan is used for non trading purposes then it is deductible against interest income. It is relievable on an accruals basis. The main examples of non trading loans are those taken out to acquire a rental / investment property, as stated above, or to acquire shares

8 Qualifying Charitable Donations

For companies to ensure tax relief is achieved on their charitable donations they should make such payments under the qualifying charitable donations system. The payment is GROSS and deductible on a paid basis. Thus in the adjustment of trading profit any such payments should be added back and instead included as a separate deduction on the Corporation Tax computation.

9 Dividends

Dividends received from **UK and overseas companies** are exempt corporation tax and never included as part of Taxable Total Profits.

EXAMPLE 1

Westmorland Ltd has the following income and outgoings for the year ending 31 March 2022.

	£
Tax-adjusted trading profit	1,456,500
Property Income	25,000
Interest receivable	10,000
Chargeable gains	37,500
Capital losses	(2,500)
Dividends from UK companies	14,400
Qualifying charitable donations	(10,000)

Compute the Taxable Total Profits for the year ending 31 March 2022.

You may now attempt Practice Question 22 and 23

Chapter 17

LONG PERIOD OF ACCOUNT

1 Apportioning income and expenditure

- (a) If a company has a period of account longer than 12 months it must be split into two Accounting Periods (AP)

- » the first 12 months
- » the remaining months

- (b) The income and expenditure of the period of account is divided between the AP's as follows:

Adjusted profit for period of a/c	Time apportioned	
Capital allowances	Separate comps for each AP	(WDA and AIA will be restricted in the second short period, but note that FYAs are never restricted for short accounting periods)

Property Income	Accruals basis
Interest receivable	Accruals basis

Qualifying charitable donations	} Date of payment/disposal
Chargeable gains	

Dividends	Date received
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EXAMPLE 1

A plc prepared accounts for a 15 month period to 30 June 2022. The results for the period are as follows:

	£
Adjusted profit	4,000,000
Chargeable gain (sale of asset on 6 May 2022)	80,000
Qualifying charitable donations (paid annually on 31 July)	20,000

The tax written down value of plant and machinery qualifying for capital allowances at 1 April 2021 was nil. The capital transactions in plant and machinery during the 15 month period were the purchase of second hand vans for £68,000 on 12 May 2021 and new plant and machinery costing £200,000 on April 14, 2022. In addition long life assets costing £310,000 were purchased on 1 June 2022.

Calculate the corporation tax liabilities for the relevant AP's

Chapter 18

TAX ADJUSTED LOSSES – COMPANIES

1 Trading and Non-Trading losses

1.1 Trading losses

If a company makes a trading loss, its trading income assessment for that period to include in the corporation tax computation is nil.

The loss may then be relieved in the current period against Total Profits, followed by a 12 month carry back to an earlier period(s) against Total Profits and / or by carry forward to relieve against ANY part of future total profits.

Note that if a company wishes to carry back a loss then it MUST firstly use the loss in the current period and unlike with the carry forward claim, partial claims are NOT allowed in either the current period or carry back claim.

Factors to consider when choosing which loss reliefs to claim will include, the cash flow benefit of achieving relief at the earliest available opportunity, avoid wasting any qualifying charitable deductions and reducing profits below the relevant profit limit to avoid having to make quarterly instalment payments

Current period and carry back claims cannot be partial as stated above and hence run the risk of wasting relief for qualifying charitable donations as Total Profits are before the deduction of donations and if they are unused they will be wasted.

If however the loss is carried forward a partial claim would be available so as to avoid wasting any qualifying charitable donations.

A current period claim followed by a carry back claim will however have a cash flow advantage over a carry forward claim thus using the loss at the earliest available opportunity.

A further most important cash flow issue is to seek, by the best use of losses, to avoid the requirement to pay the corporation tax liability by quarterly instalments - see chapter 23.

This may be particularly important within a group of companies where group relief of losses (see chapter 22) is available and allows any part of a trading loss made by one relevant group company to be set off against any part of the TTP of any other relevant group companies.

Group relief also now allows brought forward trading and property business losses to potentially be included in a group relief claim - again see chapter 22 for relevant details.

Non-Trading losses

(a) Property Business losses

Property Business losses are relieved by

- (i) Setting them off against total profits before deduction of qualifying charitable donations of the current period, and then
- (ii) By carrying them forward to set off against any part of future total profits.
- (iii) Group relief - see chapter 22

(b) Capital losses

Capital losses are relieved against:

- (i) Current year capital gains, then carried forward to set off against
- (ii) Net capital gains in future accounting periods.

2 Trading losses

2.1 Current period relief

The loss may be relieved against Total Profits before deduction of qualifying charitable donations in the period that the loss arose. The loss must be applied in full if claimed as no partial claims are permitted.

The relief must be claimed within 2 years of the end of the accounting period in which the loss is made.

EXAMPLE 1

A Ltd had the following results for the year ended 31 March 2022

	£
Trading loss	(45,000)
Interest receivable	20,000
Chargeable gain	50,000
Qualifying charitable donations	15,000

Show how current year relief would be obtained in the year ended 31 March 2022

2.2 Carryback relief

- (a) Having first relieved the trading loss in the accounting period of loss, only then may any remaining trading losses be carried back against Total Profits before deduction of qualifying charitable donations of the preceding 12 months. The loss must be applied fully against the available profits.
- (b) Partial claims, for example to leave sufficient profit to cover the qualifying charitable donation, are not allowed. These claims may therefore result in no tax relief being achieved for the qualifying charitable donations. The relief must be claimed within 2 years of the end of the accounting period in which the loss is made.

EXAMPLE 2

A Ltd has produced the following results over recent years.

	Year ended 31 March		
	2020	2021	2022
	£	£	£
Trading profit / (loss)	30,000	60,000	(90,000)
Interest receivable	10,000	10,000	10,000

Show how loss relief would be claimed assuming that relief is taken as soon as possible.

EXAMPLE 3

A Ltd has the following results:

	y/e 31/3/21	9 months to 31/12/21	y/e 31/12/2022
	£	£	£
Trading profit / (loss)	25,000	20,000	(40,000)
Bank interest	3,000	1,000	1,000
Chargeable gains / (losses)	(1,000)	6,000	–
Qualifying charitable donations	(500)	(500)	(500)

Show the Taxable Total Profits for all accounting periods, assuming loss relief is taken as soon as possible.

2.3 Losses in the final twelve months of trading

The carryback period is extended to 36 months for losses incurred in the twelve months prior to the cessation of trading. Losses can be carried back against total profits before deduction of qualifying charitable donations of the 36 months preceding the loss making period on a LIFO basis.

EXAMPLE 4

A Ltd ceased trading on 31 March 2022. It had the following results for the five accounting periods to 31 March 2022.

	y/e 30/9/18	6 months to 31/3/19	y/e 31/3/20	y/e 31/3/21	y/e 31/3/22
	£	£	£	£	£
Trading profit / (loss)	10,000	16,000	20,000	32,000	(97,000)
Bank interest	2,000	–	2,000	2,000	2,000
Chargeable gains	–	–	6,000	–	8,000
Qualifying charitable donations	500	–	500	500	–

Show the Taxable Total Profits for all accounting periods.

2.4 Carry forward relief

- (a) If any loss remains unrelieved after current year and carryback claims have been made or no such claims were made, then the loss is carried forward.
- (b) Under carry forward relief any such losses are carried forward for relief against any part of future total profits of the company. There is no time limit on the carry forward period and partial loss relief claims may be made to, for example, avoid wasting qualifying charitable donations.
- (c) A claim must be made within 2 years of the end of the accounting period in which the loss is to be relieved.

EXAMPLE 5

A plc had the following results since it started trading on 1 April 2018

	<i>y/e 31/3/19</i>	<i>y/e 31/3/20</i>	<i>y/e 31/3/21</i>	<i>y/e 31/3/22</i>
	£	£	£	£
Trading profit / (loss)	40,000	20,000	(43,000)	20,000
Property Income	3,000	3,000	3,000	3,000
Interest receivable	4,000	3,000	5,000	3,000
Qualifying charitable donations	(1,000)	(1,000)	(1,000)	(1,000)

Show how losses will be relieved on the assumption that any relief is to be taken as soon as possible.

You should now review the Corporation Tax section of the FA 2021 Technical article written by the ACCA examining team.

You should then attempt Practice Question 24.

Chapter 19

CHARGEABLE GAINS – COMPANIES

1 General

As seen in Chapter 16 companies pay corporation tax on their chargeable gains.

A chargeable gain arises on a chargeable disposal of a chargeable asset by a chargeable person as seen in Chapter 12 for individuals.

A UK resident company is chargeable on its worldwide gains and may dispose of a chargeable asset not only by sale but also on the loss or destruction of an asset.

As you will see in note 1.2 below the calculation of the gain contains one new component not applicable to individuals. Companies may be given a deduction from the gain to remove the effect of inflation from when the asset was purchased to when it is sold (or to December 2017 if that is earlier)

This deduction is known as indexation allowance but clearly will not be available if the asset was purchased post December 2017.

All assets are chargeable assets unless they are specifically exempt.

1.1 Exempt assets

A more complete list of the main exempt assets may be found in Chapter 12 dealing with individuals but the main exempt assets that a company may dispose of would be motor vehicles, qualifying corporate bonds (corporate loan stock) and certain chattels.

The main chargeable assets that a company will dispose of will be shares, land and buildings and plant and machinery. Note that on the disposal of plant and machinery upon which capital allowances have been claimed there may be no capital loss arising as any loss has been relieved through the capital allowance system against trading profits. In the unlikely situation of selling such an asset for more than cost a normal gains calculation will be performed other than with the adjustment required on the sale of a building where SBA has been claimed as seen in Chapter 5.

This and subsequent chapters will deal with these main assets.

1.2 Calculation of gains and losses for companies

	£
Disposal proceeds (or market value)	X
Less incidental costs of disposal	(X)
Net proceeds	X
Less allowable costs	(X)
Unindexed gain	X
Less indexation allowance	(X)
Chargeable gain	<u>X</u>

1.3 The indexation allowance

- (a) For companies only, NOT individuals, the increase in value of an asset due to inflation up until December 2017 is not taxable - this increase is removed from the gain by way of indexation allowance.
- (b) Companies had always been entitled to an indexation allowance computed from the month of acquisition to the month of disposal of an asset and was calculated by reference to the movement in the Retail Prices Index (RPI) and applied to the cost of the asset
- (c) The increase in the RPI is expressed as a decimal and is rounded to three decimal places, which indexation factor is then applied to the cost of the asset to compute the indexation allowance.
- (d) Indexation Allowance was frozen at December 2017 such that indexation allowance will now be given to the date of disposal or December 2017 if that is before the date of disposal.
- (e) The TX-UK syllabus no longer includes the requirement to calculate an indexation factor, such that indexation factors will now be provided in the question and the student needs simply to choose and apply the correct one! The most likely situation here being a disposal made after December 2017 and indexation factors being supplied from date of acquisition to both December 2017 and the later date of disposal.
- (f) The indexation allowance cannot increase or create a loss.
- (g) If allowable enhancement expenditure is incurred after acquisition then it will require a separate indexation factor to be applied from the month the expenditure is incurred

EXAMPLE 1

A company bought an asset on 6 June 1986 at a cost of £20,000.
Enhancement expenditure of £6,000 was incurred on 16 August 1990.
The asset is sold for £100,000 on 2 October 2022.
Incidental costs of sale are £1,000.

Calculate the chargeable gain arising on the disposal of the asset

Indexation factors are as follows:

June 1986 to October 2022	1.743
August 1990 to October 2022	1.125
June 1986 to December 2017	1.706
August 1990 to December 2017	1.067

2 Gains and losses

- (a) Capital gains are chargeable to corporation tax.
- (b) Capital losses only arise when net proceeds are less than allowable cost. Indexation allowance may not be used to either create or increase a loss.
- (c) If capital gains and losses arise in the same accounting period, they are netted off.
If the resultant figure is a gain, it is charged to corporation tax.
If the resultant figure is a loss, it is carried forward and set against future capital gains.
- (d) Capital losses may only be relieved against capital gains, not income.
- (e) The terms capital gains and chargeable gains are interchangeable.

3 Share matching rules for companies

Disposal of shares give rise to a chargeable gain or allowable loss. It is difficult however to identify which shares are being sold, and therefore establish the cost of those shares sold where it is only some of the shareholding being sold and the shares had been acquired over a period of time at different costs.

We need to identify the shares sold by using matching rules as laid down by HMRC which, as you may expect, are not exactly the same as the matching rules that we used when dealing with the same problem for individuals disposing of shares as we saw back in Chapter 13. Thus the shares sold are deemed disposed of in the following order::

- shares acquired on same day
- shares acquired in previous 9 days
- shares contained within the share pool which is made up of any shares acquired more than 9 days previous.

The share pool records the number and cost of shares for each acquisition and disposal as it did for individuals but also has to deal with the fact that companies are entitled to indexation allowance. Thus whenever shares are purchased or sold a reindexation of the indexed cost of the shares in the pool is added to the indexed cost total which is recorded in a separate Indexed Cost column of the share pool.

Once again indexation factors will be given in the question and indexation allowance is frozen at December 2018.

Follow the answer to example 2 below to see how the share pool is constructed.

EXAMPLE 2

A Ltd bought the following shares in B Ltd:

20 August 1989	1,000 shares at a cost of £5,000
16 November 1996	2,000 shares at a cost of £12,000
7 December 2022	500 shares at a cost of £5,000

A Ltd sold 3,000 shares on 10 December 2022 for £36,000

Calculate the gain arising on the disposal in December 2022.

Indexation factors are as follows:

August 1989 to December 2017	1.419
August 1989 to November 1996	0.329
November 1996 to December 2022	0.961
November 1996 to December 2017	0.820

4 Bonus issues

- A bonus issue increases the number of shares held with no corresponding increase in cost.
- The bonus shares are simply added to the number of shares column in the pool.
- Do not however index the cost of the original shares to the date of the bonus as no new cost is incurred but remember on the next purchase or sale to index the indexed cost figure from the date of the last indexation that took place, not the date of the bonus issue.

5 Rights issues

- A rights issue again increases the number of shares held, but this time there is also a cost associated with the shares. It is therefore dealt with in the same way as any other acquisition
- The indexed cost in the pool is indexed to the date of the rights issue. The rights shares are added to the number of shares column and the cost is then added to both the cost and indexed cost columns in the pool. The only problem you face is computing how many shares are acquired under the rights issue

EXAMPLE 3

Y Ltd acquired 3,000 shares in X Ltd on 20 July 1993 for £10,000. In February 1995 X Ltd made a 1:3 bonus issue.

Y Ltd sold 2,000 shares in March 2022 for £12,000.

Calculate the gain on the disposal of the shares in March 2022

Indexation factors are as follows:

July 1993 to March 2022	1.041
July 1993 to February 1995	0.087
July 1993 to December 2017	0.991
February 1995 to December 2017	0.904

6 Takeovers

- (a) Where a takeover is a share for share deal or paper for paper transaction, shareholders of the company taken over acquire shares in the acquiring company. This normally does not constitute a chargeable disposal.
- (b) The new shares are deemed to have been acquired for the same cost as the original shares.
- (c) A takeover may involve attributing the cost of the original holding to the different component parts of the new holding, if a mix of consideration is received e.g. a combination of ordinary and preference shares. This is done by allocating the cost of the original holding to the new shares according to the market value of what is received at the time of the takeover. Use the answer to example 4 below to see how the technique is applied
- (d) If at takeover, cash is received, a chargeable gain needs to be calculated at takeover for the cash element received. See example 5

EXAMPLE 4

Z Ltd acquired 10,000 A Ltd shares in August 1989 for £10,000. In July 2021 B plc takes over A Ltd and for each share in A Ltd, Z Ltd receives:

2 B plc ordinary shares valued at £1.50 each and, 1 B plc preference shares valued at £1 each.

The preference shares are sold in March 2022 for £15,000 (assume the indexation factor from August 1989 to December 2017 is 1.357).

Calculate the Gain arising as a result of the takeover in July 2021, and the sale of the B plc preference shares in March 2022

EXAMPLE 5

Using example 4 what difference would it make if Z Ltd receives at takeover

2 B plc ordinary shares valued at £1.50 each and £1 cash for each share in A Ltd.

The indexed rise between August 1989 and December 2017 is 1.275.

Chapter 20

CHARGEABLE GAINS – COMPANIES – FURTHER ASPECTS

1 Part Disposals, Chattels, Non chattel wasting assets

- 1.1** When a company disposes of a part but not all of an asset, the allowable cost of the part of the asset disposed of is computed as we saw for individuals in Chapter 12 taking the cost of the entire asset and multiplying by Proceeds / Proceeds + Value Remaining
- 1.2** This same calculation will be performed for a company but in addition the allowable cost computed will then be available for indexation allowance in the normal way.

EXAMPLE 1

ST Ltd owned 10 hectares of land which originally cost £26,000 in March 2014. ST sold 2 hectares of the land in March 2022 for £16,000.

The remaining 8 hectares were valued at £34,000 in March 2022.

Calculate the chargeable gain on the disposal of the 2 hectares of land in March 2022.

Indexation factors are as follows:

March 2014 to March 2022	0.291
March 2014 to December 2017	0.269

- 1.3** A chattel disposal is also dealt with in the same way as for an individual (see Chapter 12) but again with the availability in a normal gains calculation of indexation allowance

EXAMPLE 2

JM Ltd sold the following assets in March 2022

- (a) an antique table which had cost £3,000 in February 2012 and sold for £5,000
- (b) a painting which had cost £2,000 in January 2014 and sold for £10,000
- (c) an antique vase which had cost £8,000 in August 2002 and sold for £3,000
- (d) a vintage car which had cost £7,000 in July 1999 and sold for £9,000

Indexation factors are as follows:

February 2012 to December 2017	0.288
January 2014 to December 2017	0.285
August 2002 to December 2017	0.645
July 1999 to December 2017	0.756

Calculate the net chargeable gains or losses arising for JM Ltd in March 2022

- 1.4** A non chattel wasting asset disposed of by a company will again be dealt with as for individuals (see Chapter 12) but again with indexation allowance available on the allowable cost.

EXAMPLE 3

On 1 March 2010 Z Ltd bought a copyright at a cost of £25,000. It had an estimated useful life of 30 years, and an estimated residual value of £1,000.

Z Ltd sold the asset for £38,000 on 1 March 2022.

Assume an indexation factor of 0.436 from March 2010 to December 2017.

Calculate the chargeable gain arising on the sale of the copyright in March 2022.

2 Assets damaged, lost or destroyed

2.1 Damaged assets

- (a) If an asset is damaged and compensation or insurance money is received as a result, then this will normally be treated as a part disposal of the asset. The cost is calculated using the normal part disposal formula:

$$\frac{A}{A + B}$$

where

A = value of part disposal

B = market value (MV) of the remainder at the time of part disposal

- (b) If insurance money is received then:
- (iii) if the insurance money is not used in restoring the asset a normal part disposal arises, with the MV of the part retained equating to the value of the asset in its damaged condition.
 - (iv) if the insurance money is fully used in restoring the asset the taxpayer can elect to have the proceeds deducted from the cost of the asset for a future calculation thereby deferring any gain when the insurance proceeds are received.

EXAMPLE 4

MI Ltd bought a painting on 1 April 2000 for £10,000. The painting was damaged on 1 May 2022 when it was worth £50,000. After the damage it was only worth £25,000. On 1 July 2022 insurance proceeds of £30,000 were received but were not used to restore the painting. Assume an indexation factor from April 2000 to December 2017 of 0.549.

Calculate the chargeable gain arising on the receipt of the insurance proceeds

EXAMPLE 5

Daisy Ltd purchased a painting on 1 April 2000 for £10,000. The painting was damaged on 1 May 2022 when it was worth £50,000. After the damage it was worth £40,000.

On 1 July 2022 insurance proceeds of £8,000 were received. All of the insurance proceeds were used to restore the painting.

Assuming Daisy Ltd elects for the proceeds to be rolled over against the cost of the painting, calculate the base cost of the painting on a future disposal.

2.2 Destroyed or lost assets

- (a) If an asset is destroyed or lost and no compensation or insurance money is received there is a disposal which will result in a capital loss.

If there is any compensation or insurance monies received this will normally be brought into an ordinary gains computation as proceeds.
- (b) The date of disposal is the date the insurance money is received. If the insurance money is used to buy a replacement asset within 12 months, the gain can be deferred until the new asset is sold.
- (c) If only part of the insurance money is used to buy a replacement asset then some of the gain will be taxed immediately and some of the gain will be deferred.

EXAMPLE 6

SC Ltd bought an asset for £23,000 in June 2014. It was destroyed in October 2021. Insurance proceeds of £34,000 were received in March 2022. SC Ltd spent £30,000 on a replacement asset in June 2022

Calculate the chargeable gain and the base cost of the new asset.

Assume indexation factors are as follows:

June 2014 to December 2017	0.250
June 2014 to March 2022	0.381

Students may now attempt Practice Questions 26 & 27 and 31

Chapter 21

CHARGEABLE GAINS – COMPANIES – RELIEFS

1 Replacement of business assets (Rollover Relief)

1.1 Definition

A gain may be 'rolled over' (deferred) where it arises on the disposal of a qualifying business asset whose sale proceeds are reinvested in another qualifying business asset.

1.2 Qualifying assets

Both the old and new assets must fall into one of the following categories:

- (a) Land and buildings
- (b) Fixed plant and machinery

Both the old and new assets must be used in the business.

1.3 The relief

- (a) The gain is not taxed immediately but is postponed until the company makes a disposal of the replacement asset without further replacement.
- (b) The postponement is achieved by deducting the gain made on the old asset from the cost of the new one.
- (c) Where the disposal proceeds of the old asset are not fully reinvested, the surplus retained reduces the amount of capital gain that can be rolled over.
- (d) The replacement asset must be bought in the period 12 months before to 36 months after the disposal of the old asset.
- (e) A claim must be made within 4 years from the end of the accounting period in which the disposal occurred.

EXAMPLE 1

JM Ltd bought a building for use in the business in October 1994 for £150,000.

The building was sold in March 2022 for £400,000.

In June 2021 JM Ltd bought some land for use in the business for £500,000.

Assume an indexation factor of 0.929 from October 1994 to December 2017

Calculate the chargeable gain and the base cost of the new asset.

EXAMPLE 2

A Ltd bought land for use in the business in May 2003 for £200,000.

The land was sold in March 2022 for £350,000.

In September 2023 A Ltd bought a factory for use in the business for £335,000. Assume an indexation factor from May 2003 to December 2017 of 0.543

Calculate the chargeable gain and the base cost of the new asset.

2 Depreciating assets

2.1 Definition

- (a) An asset with an expected life of a maximum 60 years or
- (b) Fixed plant and machinery

Note: You will only be examined on fixed plant and machinery and leasehold property with a life of 60 years or less.

2.2 Effect

If the new asset is a depreciating asset.

- (a) The gain deferred is not deducted from the cost of the new asset
- (b) Instead it is postponed until the earliest of:
 - (i) disposal of the new asset
 - (ii) the date the new asset ceases to be used in the trade
 - (iii) 10 years after the new asset was acquired

EXAMPLE 3

YR Ltd bought land for use in the business in April 1997 for £200,000. The land was sold for £350,000 in May 2015. In March 2016 YR Ltd bought fixed plant for use in the business, costing £390,000.

YR Ltd sold the fixed plant in February 2022. (YR Ltd has a 31 March year end)

Calculate the chargeable gains as far as the above information allows for y/e 31 March 2016 and y/e 31 March 2022

Assume indexation factors as follows:

April 1997 to December 2017	0.812
April 1997 to May 2015	0.361
March 2016 to December 2017	0.171

- (c) When the replacement asset is a depreciating asset, the gain is deferred as in (b) above. However, if a non-depreciating asset is purchased before the deferred gain crystallises, the original gain may be rolled over against the cost of the new, non-depreciating asset and will only crystallise on sale of the non-depreciating asset..

You should now review the following technical articles written by the TX-UK examining team for exams from June 2022 to March 2023

Chargeable Gains parts 1 and 2

You may now attempt Practice Question 28

Chapter 22

CORPORATION TAX – GROUPS

1 Introduction

If companies are within a group then each such company must still prepare its own corporation tax computation. There is no taxation equivalent of consolidation as in financial reporting!

Group companies will benefit from certain reliefs but will also have certain additional rules and regulations placed upon them.

A group exists for taxation purposes where one company is a subsidiary of another. The various reliefs and rules are only applicable to members of certain group structures.

There are two types of group structure, based on the level of share ownership that are relevant for tax purposes, 51% groups and 75% groups

- (1) 51% groups issues
 - » related 51% group companies
 - » Group VAT registration (see Chapter 25)
 - » Availability of AIA
- (2) 75% groups issues
 - » group relief of losses
 - » gains group membership

2 Related 51% group companies

2.1 Definition

Companies are related 51% group companies if:

- (a) One company is a 51% subsidiary of the other or
- (b) They are 51% subsidiaries of another company

2.2 Control

A company is a related 51% group company if the parent company owns directly or indirectly more than 50% of the share capital of the subsidiary company at the end of the previous accounting period:

Dormant companies are excluded but overseas companies are included.

2.3 The tax implications

- (a) As seen in Chapter 16 the profit limit of £1.5M used to determine if a company is large and is therefore required to make quarterly instalment payments is divided between the number of related 51% group companies.

EXAMPLE 1

A Ltd owns 100% of the share capital of V Ltd, F Ltd and C Ltd and has a Taxable Total Profit of £400,000.

Is A Ltd a large company for purposes of making quarterly instalment payments?

3 The Annual Investment (AIA)

Only one AIA is available to a group of companies but the group members can allocate the AIA in any way it chooses across the group if the qualifying AIA expenditure is more than the AIA limit of £1M. A group therefore may choose to allocate the available AIA to firstly reduce the profits of large companies down to the relevant profit limit of the group company and as always to allocate to special rate pool expenditure before main pool expenditure albeit now most main pool expenditure will rank for the enhanced capital allowance of a 130% FYA.

4 Group relief

4.1 Introduction

The relief allows companies in a 75% group to transfer any part of a current year trading loss of one such group company to set off against any part of another company's taxable total profit (TTP) of a corresponding accounting period.

Group relief is also available in respect of:

- excess qualifying charitable donations and
- excess property business losses

Such losses are only excess if they exceed the total profits of the company concerned before any other losses have been applied.

As stated in Chapter 18 any unused trading losses or property business losses brought forward by a company may now also be surrendered as group relief BUT only to the extent that the loss making company is unable to set off the loss against its own total profits.

4.2 Definition of a 75% group

- (a) One company is the 75% subsidiary of another, or
- (b) Both companies are 75% subsidiaries of a third company.

The holding company must :

- (c) own at least 75% of share capital, and
- (d) be entitled to at least 75% of the subsidiary's assets on winding up, and
- (e) be entitled to at least 75% of the subsidiary's profits on a distribution.

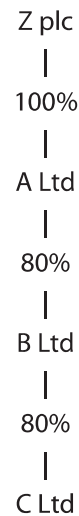
4.3 Sub-subsidiaries

The holding company must have an EFFECTIVE interest in any sub-subsidiary of at least 75% for them to be in the same group for group relief purposes, for example if a parent company owns 90% of the shares in a subsidiary which in turn owns 90% of its subsidiary then all 3 companies would be able to group relieve with one another as the parent company has an effective 81% interest ($90\% \times 90\%$) in the sub-subsidiary.

If the subsidiary owned only 80% of the shares in the sub-subsidiary, then the parent company may only group relieve with its direct subsidiary as its effective holding in the sub-subsidiary is only 72% ($90\% \times 80\%$). The sub-subsidiary may only group relieve with the subsidiary company, but the subsidiary company is in a group relief group with both its parent company and its own subsidiary company and is therefore able to group relieve with either its parent company or its own subsidiary.

EXAMPLE 2

Z plc is the holding company for a group of companies. The group structure is as follows:



For the year ended 31 March 2022 Z plc has a trading loss.

State the companies to which Z plc may surrender its trading loss in y/e 31 March 2022

4.4 Group loss relief

- (a) Trading losses may be surrendered to other companies in the group, which may then relieve the losses against their own taxable total profits.
- (b) Any member company may surrender its loss to any other member of the group:
 - » a holding company may surrender a loss to its subsidiary company
 - » a subsidiary company may surrender a loss to its holding company
 - » a subsidiary company may surrender a loss to a fellow subsidiary company.
- (c) The surrendering company is the company that surrenders its loss.
- (d) The claimant company is the company to which the loss is surrendered.

4.5 The surrendering company

- (a) The surrendering company may surrender as much of its trading loss as it wants to
- (b) It is not necessary to relieve a trading loss against its own income and gains first.
- (c) The losses which may be surrendered are:
 - » any amount of a current period trade loss
 - » unrelieved qualifying charitable donations of period
 - » unrelieved property business losses of period
 - » unrelieved trading and property business losses brought forward can be surrendered as group relief but only to the extent that they cannot be set off against the surrendering company's own total profits.

Note that capital losses are not eligible for group relief but are dealt with separately under gains group membership.

4.6 The claimant company

The relief is taken against the TTP of the same period as the surrendering company's loss making period.

4.7 Group relief

- (a) The important points to remember as regards group relief are:
 - » Losses can be group relieved against 100% of a 75% subsidiary's TTP, or conversely 100% of a 75% subsidiary's loss can be group relieved.
 - » The relief is not restricted to the percentage shareholding.
 - » Any amount of current year trade and business property losses can be group relieved.
 - » Amounts of brought forward unused trading and business property losses that cannot be set off in surrendering company may also be group relieved
- (b) Where the accounting periods of two group companies are different, then group relief will be restricted to the corresponding or coterminous period. It is therefore necessary to time apportion both the loss making period and the profit making periods to calculate how much loss may be set against how much profit in each AP
- (c) In TX-UK only UK resident companies are eligible for group relief though two UK resident subsidiaries of an overseas resident parent company would be able to group relieve with one another though neither could group relieve with its overseas parent company

EXAMPLE 3

Continuing with Example 2 suppose that B Ltd had commenced trading on 1 October 2021 preparing accounts for the six-month period to 31 March 2022

Discuss the group relief available in respect of Z plc trading loss for y/e 31 March 2022 if it were to consider surrendering the trading loss to B Ltd.

EXAMPLE 4

Beyonce Ltd prepares its accounts to 31 March in each year and has two wholly owned subsidiaries J Ltd and Z Ltd. J Ltd has been owned for several years but prepares its accounts to 30 June, while Z Ltd started trading on 1 January 2022 and made a trading profit of £50,000 in its 3 month period to 31 March 2022. Beyonce made a trading loss of £240,000 in its year ended 31 March 2022 while J Ltd has Taxable Total Profits of £160,000 for the year ended 30 June 2021 and £280,000 for the year ended 30 June 2022.

Compute the maximum group relief claims available to J Ltd and Z Ltd in respect of Beyonce's loss of £240,000.

4.8 Payment for group relief

The claimant company may make payments to the surrendering company for group relief. Any payment up to the amount of the loss surrendered is ignored for corporation tax purposes.

5 Groups – Chargeable gains**5.1 Definition of a 75 % group**

- (a) A group consists of a parent company and its 75% subsidiaries, and also the 75% subsidiaries of their subsidiaries.
- (b) The parent company need only have an effective interest of over 50% in any sub-subsidiary companies.
- (c) Groups may be established through a parent company resident anywhere in the world.

5.2 The Tax Implications

- (a) Group companies will transfer assets between themselves without incurring a chargeable gain or allowable loss. This will be a no gain / no loss transfer and will be deemed to take place at a value equal to the cost of the asset to the transferor company plus the available indexation allowance - remember that indexation allowance runs only to December 2017 at latest.
- (b) Group companies can make an election such that any part of a capital gain or loss incurred by one company may be treated as arising in another company.
- (c) Members of a 75% group are treated as one for the purposes of roll over relief.

Where:

- » one company sells a qualifying asset, and
- » another company buys a qualifying asset within the rollover relief qualifying time period.
- » the gain can be rolled over

5.3 Advantages of Gains Group membership

- (a) The group's capital losses can be better utilised
- (b) Rollover relief is available on a group wide basis
- (c) Gains may be moved to a company with insufficient profits to cover its qualifying charitable donations or out of a company where its profits exceed the profit limits for purposes of making quarterly instalment payments.

5.4 Capital losses

- (a) An asset does not have to be moved between group companies in order to match capital losses and gains.
- (b) Companies in a capital gains group can make an election to deem any part of a current period gain or loss made by one group member to have been made by any other gains group member.
- (c) The election has to be made within two years of the end of the accounting period in which the asset is disposed of outside the group.
- (d) The advantages of the election
 - » The two-year time limit for making an election means that tax planning regarding the set-off of capital losses and gains can be done retrospectively.
 - » By not having to actually transfer assets within a group means a saving in legal and administrative costs
 - » The election can be made in respect of any part of a capital gain or capital loss.

EXAMPLE 5

During the year ended 31 March 2022 Large Ltd disposed of an asset that resulted in a capital loss of £35,000. Smaller Ltd, the 100% subsidiary of Large Ltd, disposed of an asset that resulted in a capital gain of £100,000. Large Ltd has Taxable Total Profits of £1M and Smaller Ltd has Taxable Total Profits of £800,000 including the chargeable gain and anticipates larger profits in the next accounting period. Large Ltd holds no other shareholdings.

Discuss the elections available to the group companies and how they may best be used.

You should now review the following technical article written by the TX-UK examining team for exams from June 2022 to March 2023

Groups