

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 **chargeable accounting periods**. Normally a company's chargeable accounting period (CAP) 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 2018 = 1 April 2018 to 31 March 2019, and

FY 2017 = 1 April 2017 to 31 March 2018

For both FY 2018 and FY 2017 the rate of corporation tax is 19%, but for FY 2016 the tax rate was 20%.

If therefore the CAP of a company straddled FY 2016 and FY 2017 the TTP on the corporation tax computation must be time apportioned between the 2 FYs spanned and the separate tax rates then applied to each FY (see Illustration 1 below)

ILLUSTRATION 1

Straddle Ltd has a TTP of £800,000 for its accounting year ended 31 December 2017

As the CAP straddles 31 March 2017, the first 3 months of the CAP falls within FY 2016 and the final 9 months of the CAP falls within FY 2017. Therefore 3/12 of the TTP must be taxed at the FY 2016 rate of 20% and 9/12 of the CAP must be taxed at the FY 2017 tax rate of 19%. The corporation tax liability would therefore be computed as follows:

FY 2016	$3/12 \times 800,000 = 200,000 \times 20\% =$	40,000
FY 2017	$9/12 \times 800,000 = 600,000 \times 19\% =$	114,000
CT Liability		<u>154,000</u>

As stated above a company may change its accounting date and therefore have a period of account of either less than or more than 12 months, but a CAP can never exceed 12 months, hence there will always be a CAP of less than 12 months whichever way a company changes its accounting date (see chapter 17 for when a company has a long period of account - more than 12 months - for how the period of account is divided between 2 CAP).

ILLUSTRATION 2

Straddle Ltd had always prepared accounts to 31 December in each year, the last such accounts being to 31 December 2016. It then changed its accounting date to 30 September and prepared accounts for the 9 month period to 30 September 2017 for which period it had a TTP of £900,000.

The corporation tax liability will therefore be computed as follows:

FY 2016	$3/9 \times 900,000 = 300,000 \times 20\% =$	60,000
FY 2017	$6/9 \times 900,000 = 600,000 \times 19\% =$	114,000
		<u>174,000</u>

A company usually has to pay its CT liability 9 months and 1 day after the end of its CAP, 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 CAP. 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 a CAP of less than 12 months.

ILLUSTRATION 3

Large Ltd prepares its accounts to 31 March in each year and for the accounting year ended 31 March 2019 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 Chargeable Accounting periods

- A CAP will normally start immediately after the end of the preceding CAP.
- A CAP will also start when a company commences to trade, or when its profits otherwise become liable to corporation tax.
- A CAP will normally finish twelve months after the beginning of the period or at the end of a company's period of account.
- A CAP 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 and is then charged to tax at the relevant corporation tax rate.

Pro forma corporation tax computation

Corporation Tax Computation for the year ended 31 March 2019

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

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	(X)
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 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 and is also tax relievable against interest income (interest receivable from HMRC is taxable as interest income)

5.3 Capital allowances

As per unincorporated business, (see chapter 5) but, there are no private use assets and note only one AIA is allowable to a group of companies.

5.4 Basis periods

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

6 Property Income

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

- (a) The property income is calculated on an accruals basis for the CAP
- (b) Interest payable on a loan to buy a rental property is deductible against interest income not property income under the non trading loan relationship rules
- (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 never included as part of Taxable Total Profits.

EXAMPLE 1

Westmorland Ltd has the following income and outgoings for the year ending 31 March 2019.

	£
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 2019.

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 Chargeable Accounting Periods (CAP)

- » the first 12 months
- » the remaining months

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

Adjusted profit for period of a/cTime apportioned

Capital allowances	Separate comps for each CAP	(WDA and AIA will be restricted in the second short period, but note that FYAs on motor cars with emissions ≤ 50 g/km are never restricted for short accounting periods)
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Property Income	Accruals basis
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Interest receivable	Accruals basis
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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 2019. The results for the period are as follows:

	£
Adjusted profit	4,000,000
Chargeable gain (sale of asset on 6 May 2019)	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 2018 was nil. The capital transactions in plant and machinery during the 15 month period were the purchase of new vans for £68,000 on 12 May 2018 and plant and machinery costing £77,500 on April 14, 2019.

Calculate the corporation tax liabilities for the relevant CAP'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.

The use of the loss carried forward in this way is only available for losses arising from 1 April 2017 but thankfully brought forward losses that arose prior to 1 April 2017 are excluded from the syllabus!

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.

As the corporation tax rate has fallen from 20% to 19% from FY 2017, the choice of which loss relief to claim will be based on factors such as achieving relief at the highest tax rate and at the earliest available opportunity, therefore depending on the dates of the accounting period of loss, potentially favouring a current period and then a carry back claim rather than a carry forward claim.

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 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 is available and allows any part of a trading loss or business property loss made by one relevant group company to be set off against any part of the TTP of any other relevant group companies - see chapter 22. 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.

EXAMPLE 1

A Ltd had the following results for the year ended 31 March 2019

	£
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 2019

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.

EXAMPLE 2

A Ltd has produced the following results over recent years.

	Year ended 31 March		
	2017	2018	2019
	£	£	£
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:

	<i>y/e</i> <i>31/3/17</i>	<i>9 months to</i> <i>31/12/17</i>	<i>y/e</i> <i>31/12/2018</i>
	<i>£</i>	<i>£</i>	<i>£</i>
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 2019. It had the following results for the five accounting periods to 31 March 2019.

	<i>y/e</i> <i>30/9/15</i>	<i>6 months to</i> <i>31/3/16</i>	<i>y/e</i> <i>31/3/17</i>	<i>y/e</i> <i>31/3/18</i>	<i>y/e</i> <i>31/3/19</i>
	<i>£</i>	<i>£</i>	<i>£</i>	<i>£</i>	<i>£</i>
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 2015

	<i>y/e 31/3/16</i>	<i>y/e 31/3/17</i>	<i>y/e 31/3/18</i>	<i>y/e 31/3/19</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 2018 Technical article written by the ACCA examining team and work Examples 37 - 38

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 are given a deduction from the gain to remove the effect of inflation from when the asset was purchased to when it is sold, this deduction is known as indexation allowance.

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.

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 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 has now been 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 2018.
 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 2018	1.743
August 1990 to October 2018	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 brought forward 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 2017.

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 March 2019	500 shares at a cost of £5,000

A Ltd sold 3,000 shares on 10 March 2019 for £36,000

Calculate the gain arising on the disposal in March 2019.

Indexation factors are as follows:

August 1989 to December 2017	1.419
August 1989 to November 1996	0.329
November 1996 to March 2019	0.861
November 1996 to December 2017	0.820

4 Bonus issues

- (a) A bonus issue increases the number of shares held with no corresponding increase in cost.
- (b) The bonus shares are simply added to the number of shares column in the pool.
- (c) Do not however index the cost of the original shares to the date of the bonus as no new cost is incurred.

5 Rights issues

- (a) 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
- (b) 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 2019 for £12,000.

Calculate the gain on the disposal of the shares in March 2019

Indexation factors are as follows:

July 1993 to March 2019	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 2017 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 2019 for £15,000 (assume the indexed rise from August 1989 to December 2017 is 1.357).

Calculate the Gain arising as a result of the takeover in July 2018, and the sale of the B plc preference shares in March 2019

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.

You should now review the note on Indexation Allowance in the Finance Act 2018 technical article written by the TX-UK examining team and work Example 39

You may then attempt Practice Question 25