CHAPTER 1

INTRODUCTION TO CORPORATION TAX

1.1 Introduction

Corporation tax is charged on **any corporate body**. Corporate bodies include both **limited and unlimited** companies. Corporation tax also applies to **unincorporated associations**. These include members' clubs and political associations. CTA 2010, s.1121

A company is basically any body which has been **incorporated** and a company will be denoted with the terms **Ltd** (limited) or **plc** (public limited company). An unlimited company will not have such letters at the end of its name. In order to be a properly registered company, it must be **registered at Companies House**.. CTA 2009, s.2

EU regulations permit the formation of a Societas Europaea (SE), a European company. The SE will be subject to the tax rules of the country in which it is resident CTA 2009, s.13

Companies are charged to corporation tax on **income and chargeable gains** ("profits"). Broadly, companies will have trading profits, non trading profits, property income and capital gains. We will look at detailed calculations of each as we progress through the manual.

1.2 Residence

A company is **resident** in the UK if it is **incorporated in the United Kingdom,** i.e. it is registered at Companies House either in England, Wales, Scotland or Northern Ireland. CTA 2009, s.14

Companies which are not incorporated in the UK are resident here if their place of **central management and control** is in the UK. When answering this question, we have to look to see where the directors of the company live and meet. If this is in the UK, the company is highly likely to be considered as UK resident.

Companies which are resident in the UK are **liable to tax on their worldwide income and gains,** i.e. income earned and gains realised all over the world. CTA 2009, s.5(1)

However, there is **still a liability to UK corporation tax by non-resident companies.** Assume a company is resident for tax purposes in France but is trading in the UK through a permanent establishment. This company will be subject to UK corporation tax **on any trading profits, UK property income and chargeable gains** which are attributable to the permanent establishment. CTA 2009, s.19

1.3 Chargeable accounting periods

Companies are liable to corporation tax for each chargeable accounting period. The **chargeable accounting period is usually** the period for which the company makes up a set of accounts. For example, a **company prepares a set of accounts** for the year ended 31 December 2010. This is known as the company's period of account or POA. This company will also have a chargeable accounting period or CAP for the year ended 31 December 2010.

There are also special rules which apply to determine when a chargeable accounting period begins and when it ends.

A chargeable accounting period **begins** on the earliest of: CTA 2009, s.9

(i) the commencement of trading by the company;

(ii) the acquisition of a source of income;

(iii) the company becoming resident in the United Kingdom;

(iv) immediately after the previous chargeable accounting period ends.

A chargeable accounting period **ends** on the earliest of: CTA 2009 , s.10

CTA 2009 , s.12

(i) the **cessation or commencement** of trading;

(ii) the company becoming **dormant,** i.e. having no sources of income;

(iii) the end of a company's **period of account**;

(iv) **12 months after** it began;

(v) on the commencement of a winding-up of the company;

(vi) the company entering into administration;

(vii) the company **beginning or ceasing to be resident** in the United Kingdom.

A chargeable accounting period or CAP **can never exceed 12 months** in length.

Illustration 1

Oak Ltd was incorporated on 1 January 2009. The company opened an interest bearing bank account on 1 March 2009 and commenced to trade on 1 June 2009. Oak Ltd prepared its first set of accounts to 31 August 2010 and annually thereafter to 31 August.

The incorporation of Oak Ltd does not cause a chargeable accounting period to commence.

The first chargeable accounting period (CAP) commences on 1 March 2009, the date Oak Ltd first acquires a source of income by opening an interest bearing bank account.

Commencing to trade on 1 June 2009 will cause a new chargeable accounting period to begin. Therefore, the first CAP must end on 31 May 2009, the day before trade commences.

A CAP can not exceed 12 months in length, hence the second CAP will end on 31 May 2010.

The third CAP will commence on 1 June 2010, the day after the second CAP ended, and will end on 31 August 2010, the end of Oak Ltd's period of accounts.

The first three CAPs are therefore:

First CAP: 1 March 2009 – 31 May 2009 (3 months)

Second CAP: 1 June 2009 – 31 May 2010 (12 months)

Third CAP: 1 June 2010 – 31 August 2010 (3 months)

1.4 Pro forma corporation tax computation

<u>A Ltd</u>

<u>Corporation tax computation for the chargeable accounting period (≤ 12 months)</u>

	£	£
Trading Income		
Adjusted profits before capital allowances	X	
Less: capital allowances	<u>(X)</u>	
Trade profit		X
Other Income		
Non-trading profits (loan relationships)		X
Non-trading gains (non-trade IFAs)		X
Miscellaneous income		X
UK property business		X
Overseas property business		X
Net chargeable gains		X
Less: Qualifying charitable donations		<u>(X)</u>
Taxable Total Profits (TTP)		<u>**X**</u>

TTP x appropriate rate	X
Less: Marginal relief (if applicable)	(X)
Corporation tax liability	X

1.5 Corporation tax computation

Until 2009, companies classified their income under a system of schedules and cases. The introduction of the Corporation Taxes Act 2009 (CTA 2009) marked the removal of this schedular system for companies.

Trade profit taxes the profits arising from a **company's trading activities**. This is the most important source of income as far as most companies are concerned CTA 2009, s.35

The calculation of the trade profit figure brought into a corporation tax computation is similar to the calculation for sole traders and partnerships. There are some important differences that are highlighted below and a reminder of the common adjustments to profits are included at the end of this chapter. CTA 2009, s.53-92

	£
Profit before tax per accounts	X
Add back: Disallowable expenditure	X
Deduct: Income not taxed as trading income	(X)
Tax adjusted profits before capital allowances	X
Deduct: Capital allowances	(X)
Trade profit	X

In adding back disallowable expenditure there are **no adjustments for private expenditure** by a company. The director or employee is taxed on the private expenditure as employment income, hence there is no restriction on the amount the company is allowed to deduct for corporation tax purposes.

Interest expense, to the extent that it has **been incurred on a non-trading loan, must also be added back**. Instead, relief is given for this interest expense as a non-trading debit. An example of a non-trading loan is a loan used to buy an investment such as a rental property or shares in another company. This will be covered in more detail in a later chapter.

Dividends paid by a company are simply an appropriation of profits to the shareholders and are **not** an allowable trading expense. Hence we **start with the profit before tax figure** in the accounts to calculate the trade profit because this is also before deducting dividends paid.

Dividends received by a company **do not normally form part of its trading income** as they will usually be exempt. Therefore, they are normally **deducted** in arriving at the trade profit.

Capital allowances for a company are always calculated for the **chargeable accounting period** and not for the period of accounts. Therefore, the capital allowances computation for a company can **never be for more than 12 months**.

Remember that **private use adjustments never apply to companies,** so there will never be a private use asset column. There is a pro forma for capital allowances included at the end of the chapter as a reminder.

Non-trading profits (loan relationships) taxes **profits from UK and overseas non-trading loan relationships**. We will cover the loan relationship ("LR") rules in a later chapter, but basically non-trading profits (LR) taxes all non-trading interest receivable by companies, less interest payable on non-trading loans. CTA 2009, s.292 -420

Non-trading profits (LR) are normally calculated on an "accruals" basis for companies. UK interest income is received gross by companies and for exam purposes, all interest income is dealt with under non-trading profits (LR) unless the company's trade is that of lending money, such as a bank.

Non-trading gains (IFAs) taxes income relating to non-trading Intangible Fixed Assets (IFAs). CTA 2009, s.711-906

Miscellaneous income is a "**catch all".** Where we can not find another category to tax a particular item under, it will usually be caught within miscellaneous income.

UK property business taxes income from **property** situated in the UK and the rules for companies are similar to the rules for UK property business profits for individuals. CTA 2009, s.202-291

Overseas property business taxes income from property situated overseas.

Dividends received by companies are normally not taxable. However, they do affect the rate of corporation tax that the company will pay. We will look at the calculation of corporation tax in the next chapter.

Companies pay corporation tax on their capital gains for the chargeable accounting period whereas individuals pay a separate tax (CGT) on their capital gains.

The same rules are used for calculating gains for companies as for individuals, except that companies are allowed a further deduction called **indexation allowance** in arriving at their chargeable gains.

	£
Net disposal proceeds	X
Less: acquisition cost	(X)
Less: enhancement expenditure	(X)
Unindexed gain	X
Less: indexation allowance	(X)
Chargeable gain	X

Indexation allowance adjusts for the effects of **inflation** between the date the acquisition cost or enhancement expenditure was incurred until the date of the disposal using the **Retail Prices Index** (RPIs).

The cost to be adjusted for inflation is multiplied by an '**indexation factor'**.

The formula for calculating the indexation factor is as follows:

$$\text{Indexation factor} = \frac{\text{RPI at disposal} - \text{RPI at acquisition}}{\text{RPI at acquisition}}$$

The indexation factor is always expressed as a decimal and is **rounded to three decimal** places using normal mathematical rounding. RPIs are provided in the tax tables.

The net gains for the chargeable accounting period are **included in TTP**. The net gains are all of the chargeable gains made in the chargeable accounting period less any current period capital losses and any unused capital losses brought forward. Companies do not receive an annual exemption.

Illustration 2

Porter Ltd bought an office for a total cost of £150,000 on 10 January 2001. Porter Ltd sold the office on 10 May 2010 for gross sale proceeds of £400,000. Estate agents fees of £5,000 were incurred on the sale.

Porter Ltd prepares accounts to 30 September each year.

To calculate Porter Ltd's chargeable gain we deduct the estate agent's fees of £5,000 from the £400,000 gross sale proceeds to give net sale proceeds of £395,000.

The acquisition cost of £150,000 is then deducted to give Porter Ltd an unindexed gain of £245,000.

Finally, we must deduct indexation allowance. The first thing we do is calculate the indexation factor. The indexation factor runs from the date of acquisition, January 2001, to the date of disposal, May 2010.

$$\text{Indexation factor} = \frac{223.6 - 171.1}{171.1} = 0.307 \text{ (rounded to 3 dp)}$$

The indexation allowance is calculated by taking the indexation factor, and multiplying it by the acquisition cost.

Indexation allowance = 0.307 x £150,000 = £46,050

The indexation allowance of £46,050 is deducted from the unindexed gain of £245,000 to give a chargeable gain on sale of the office of £198,950.

It is this chargeable gain of £198,950, net of any capital losses Porter Ltd has made in the CAP or any unused capital losses brought forward, that will go onto Porter Ltd's corporation tax computation for the year ended 30 September 2010.

The whole computation is therefore as follows:

	£
Gross sale proceeds (May 2010)	400,000
Less: estate agent's fees	(5,000)
Net sale proceeds	395,000
Less: acquisition cost (January 2001)	(150,000)
Unindexed gain	245,000
Less: indexation allowance	
$\frac{223.6 - 171.1}{171.1} = 0.307 \times £150,000$	(46,050)
Chargeable gain	£198,950

The calculation of chargeable gains for companies is covered in more detail in a later chapter.

Qualifying charitable donations made by a company are allowed as deductions in arriving at the company's taxable total profits for the chargeable accounting period. CTA 2010, s.189

Qualifying charitable donations consist of: CTA 2010, s.191

- **Cash donations** to charity (these are always paid gross by a company), and CTA 2010, s.204
- **Gifts of shares** quoted on a recognised Stock Exchange (and the AIM) to charity, and CTA 2010, s.205
- **Gifts of UK land and buildings** to charity.

For cash donations, the amount paid to charity is deducted in arriving at TTP for the chargeable accounting period in which the donation is made.

For gifts of shares or UK land and buildings, it is the market value at the date of the gift (plus any costs of transfer) which are deductible in arriving at the TTP for the chargeable accounting period in which the gift is made.

Illustration 3

Anfield Ltd draws up accounts for the year ended 31 March 2011. Results are as follows:

	£	£
Turnover		950,000
Less: Cost of sales		(490,000)
Gross profit		460,000
Bank interest receivable		10,000
Expenditure:		
Wages and salaries	212,000	
Depreciation expense	85,000	
Cash donation to charity	5,000	
Motor expenses	20,000	
		(322,000)
Profit before tax		148,000
Taxation expense		(35,000)
Profit after tax		113,000
Dividend expense		(50,000)
Retained profit		£63,000

Notes:

1. Salaries include £75,000 paid to the directors of Anfield Ltd.
2. Motor expenses include £8,000 re the sales director's car. The sales director uses his car 80% of the time for business purposes.

3. The general pool had a tax written down value of £62,000 at 1 April 2010. The tax written down value of the sales director's car (which was acquired in May 2008) was £19,500. There were no acquisitions or disposals during the year.

To calculate Anfield Ltd's TTP for the year ended 31 March 2011 we start by calculating the trade profit.

Profit before tax is £148,000 to which we add back the depreciation expense of £85,000 and the cash donation to charity of £5,000 as disallowable expenditure. The salaries paid to the directors and the private motor expenses of the sales director are all allowable expenses for Anfield Ltd so no add back is required for these.

We then deduct the bank interest receivable of £10,000 since interest income is taxed under the loan relationship rules and will be non-trading profit (LR).

This leaves Anfield Ltd with tax adjusted profits before capital allowances of £228,000.

Remember there is no tax relief on dividends paid by a company, they are simply an appropriation of profit.

Next we calculate Anfield Ltd's capital allowances for the chargeable accounting period, ignoring any private use of the sales director's car.

Year ended 31 March 2011	General pool	Expensive car	Allowances
	£	£	£
Tax WDV b/f at 1.4.10	62,000	19,500	
WDA @ 20%	(12,400)		12,400
WDA restricted		(3,000)	3,000
Tax WDV c/f at 31.3.11	49,600	16,500	15,400

The capital allowances of £15,400 are deducted from the tax adjusted profits before capital allowances to give a trading profit of £212,600.

		£
Profit before tax per accounts		148,000
Add back:	Depreciation expense	85,000
	Cash donation to charity	5,000
Less:	Bank interest receivable	(10,000)
Tax adjusted trading profits before capital allowances		228,000
Less:	Capital allowances	(15,400)
Trade Profit		212,600

Next we prepare the corporation tax computation for the year ended 31 March 2011. We have already calculated the trade profit figure as £212,600.

The non-trading profit is simply the bank interest receivable of £10,000 and the £5,000 donation to charity will be deducted as a qualifying charitable donation.

Anfield Ltd

Corporation Tax Computation for the year ended 31 March 2011

	£
Trade profit	212,600
Non-trading profits (LR)	10,000
Less: Qualifying charitable donation	(5,000)
TTP	**£217,600**

Example 1

Which of the following are chargeable to corporation tax?

a) Online Tutors Limited
b) Unilever Plc
c) Oxfam
d) Seaford Golf Club
e) London Borough of Camden
f) The Green Party
g) Chris Jones
h) The Jones Family Trust

Example 2

Advent Ltd is incorporated on 1 June 2011 and makes up its accounts to 31 October 2012. It opens an interest bearing bank account on 1 September 2011 and starts trading on 1 October 2011.

What are Advent Ltd's first three chargeable accounting periods?

Example 3

Walton Ltd has the following income/payments during the year to 31 March 2011:

Accounting profits (after charging depreciation of £3,000)	£60,000
Rental income	£7,000
Payment to Oxfam	£6,000

Calculate the company's TTP for the year ended 31 March 2011.

Example 4

The following information is relevant for Dexter Ltd for the year ended 31 March 2011:

	£	£
Turnover		1,890,000
Less: Cost of sales		(780,000)
Gross profit		1,110,000
Rental income		30,000
Bank interest receivable		8,000
Expenditure:		
Wages and salaries	495,000	
Depreciation expense	220,000	
Profit on sale of fixed asset	(88,000)	
Motor expenses	64,000	
Sundry expenses	40,000	
		(731,000)
Profit before tax		417,000
Taxation expense		(98,000)
Profit after tax		£319,000

Notes:

1. Motor expenses include £12,000 re the managing director's car. The managing director uses his car 60% of the time for business purposes.

2. Sundry expenses include a £6,000 donation to Oxfam.

3. An office building was sold on 3 March 2011 for £460,000. The office cost £350,000 on 10 June 2005.

4. Capital allowances on plant and machinery were £45,000 for the year ended 31 March 2011.

Calculate Dexter Ltd's TTP for the year ended 31 March 2011.

Answer 1

a), b), d) and f) are chargeable to Corporation Tax.

Online Tutors Limited is a limited company and therefore is liable to Corporation Tax, as is Unilever plc.

Oxfam is a charity, and charities do not pay Corporation Tax and so therefore there is no liability.

The Seaford Golf Club, being a members' club, is liable to Corporation Tax. However, the London Borough of Camden is not liable, as it is a local authority.

Being a political association, the Green Party is clearly an unincorporated association and liable to Corporation Tax.

Chris Jones and the Jones' Family Trust are liable to Income Tax and therefore outside the Corporation Tax regime.

Answer 2

1.9.2011 – 30.9.2011
1.10.2011 – 30.9.2012
1.10.2012 – 31.10.2012

The incorporation of a company, i.e. registering at Companies House, does not trigger the start of a chargeable accounting period. There is no income so nothing to tax. A chargeable accounting period will only begin on the acquisition of a source of income. Consequently, the first chargeable accounting period will begin on 1 September 2011, when the interest bearing bank account is opened and will end on commencement of trade. So the first chargeable accounting period will run from 1 September 2011 to 30 September 2011.

The second chargeable accounting period will start on commencement of trading and will end on 30 September 2012, 12 months after it started.

The third chargeable accounting period will begin immediately after the previous chargeable accounting period came to an end, i.e. on 1 October 2012, and will end on 31 October 2012 when the period of account ends.

Answer 3

	£
Profit	60,000
Add: Depreciation expense	3,000
Trade profit	63,000
UK property business	7,000
	70,000
Qualifying charitable donation	(6,000)
TTP	**£64,000**

The profit of the company was £60,000 but this was after charging depreciation.

Depreciation is not an allowable expense for tax purposes so therefore, we must add back the £3,000 in arriving at the trade profit figure.

We then bring in the company's other income, in this case the UK property business, which makes the company's total income £70,000.

We then deduct the company's qualifying charitable donation, being the payment to charity of £6,000 which would have been paid gross. That leaves us with TTP of £64,000.

Answer 4

		£
Profit before tax per accounts		417,000
Add back:	Depreciation expense	220,000
	Donation to Oxfam	6,000
Less:	Profit on sale of fixed asset	(88,000)
	Rental income	(30,000)
	Bank interest receivable	(8,000)
Tax adjusted trading profits before capital allowances		517,000
Less:	Capital allowances (given)	(45,000)
Trade profit		472,000

The profit before tax of the company was £417,000. This is our starting point in the calculation of trade profit.

Depreciation expense and payments to charity are not allowable expenses for tax purposes. Therefore, we must add back £220,000 of depreciation expense and £6,000 of payments to charity. Remember there is no adjustment for private expenditure for companies.

We then deduct any income that is not taxed as trade profit, this includes the profit on sale of the fixed asset (this is an accounting entry only), rental income of £30,000 (which is taxed as UK property business) and the bank interest receivable of £8,000 (which is taxed as non-trading profit (LR)).

We then deduct the capital allowances on plant and machinery which gives Dexter Ltd a trade profit of £472,000.

Next we prepare the corporation tax computation for the year ended 31 March 2011. We have already calculated the trade profit figure as £472,000.

The non-trading profit (LR) is simply the bank interest receivable of £8,000, UK property business is the £30,000 of rental income and we have to calculate a chargeable gain on the disposal of the office.

	£
Gross sale proceeds (March 2011)	460,000
Less: acquisition cost (June 2005)	(350,000)
Unindexed gain	110,000
Less: indexation allowance $\frac{236.3 - 192.2}{192.2} = 0.229 \times £350,000$	(80,150)
Chargeable gain	29,850

The £6,000 donation to charity will be deducted as a qualifying charitable donation, leaving Dexter Ltd with TTP of £533,850 for the year ended 31 March 2011.

Dexter Ltd

Corporation Tax Computation for the year ended 31 March 2011

	£
Trade profit	472,000
Non-trading profit (LR)	8,000
UK property business	30,000
Chargeable gain	29,850
Less: Qualifying charitable donation	(6,000)
TTP	**£533,850**