CHAPTER 2

COMPUTATION OF CORPORATION TAX

2.1 Rates of tax

Companies pay Corporation Tax for a **chargeable accounting period** or CAP. The rules for determining the **CAPs** of a company were covered in the first chapter.

Corporation tax is calculated based on rates of tax set by the Chancellor of the Exchequer for each financial year. A financial year for companies runs from 1 April to 31 March and is denoted by the year in which it begins. For example, the **financial year 2010 (FY 2010) runs from 1 April 2010 to 31 March 2011.** CTA 2010, s.3 CTA 2010, s.18

The rates of tax applicable in the last two financial years are as follows and are given in your tax tables:

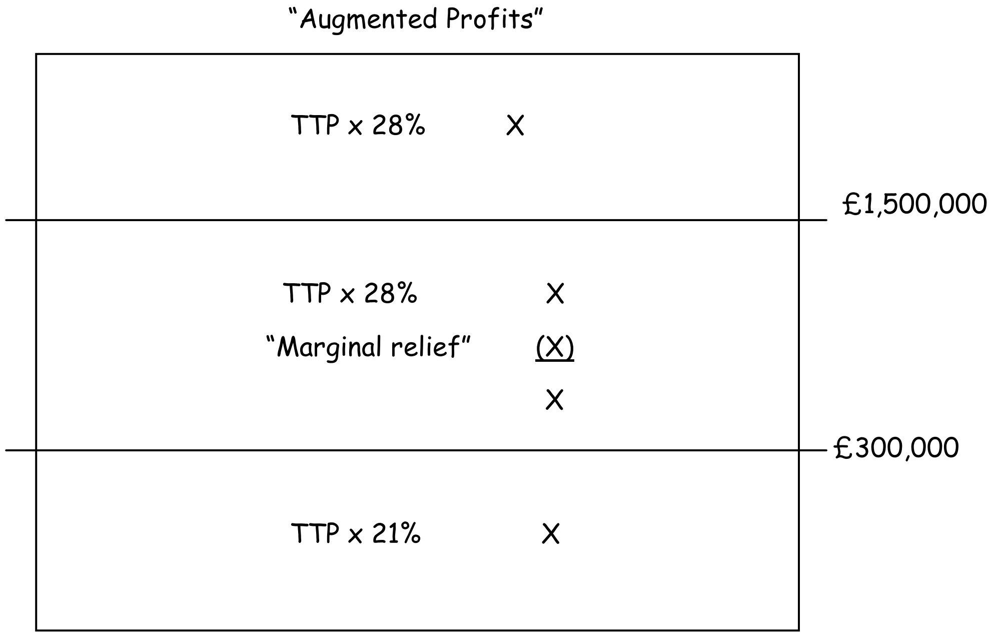
Financial Year	**2010**	**2009**
Main rate	28%	28%
Small profits rate	21%	21%
Augmented profit limit for small profits rate (often referred to as the lower limit)	£300,000	£300,000
Augmented profit limit for marginal relief (often referred to as the upper limit)	£1,500,000	£1,500,000
Standard fraction for marginal relief	$\frac{7}{400}$	$\frac{7}{400}$

Companies pay **tax on** their taxable total profits **(TTP).** However, the **rate of tax is determined** by a company's **"augmented profits" (AP).**

For example, if a company has augmented profits of £2m, it will be a "large" company and will pay corporation tax on the whole of its TTP at the main rate of tax, which is currently 28%. CTA 2010, s.3

A company with augmented profits of, say, £100,000 will be a "small" company and its TTP would be fully charged at the small profits rate of tax, which is currently 21%. CTA 2010, s.18
Companies whose augmented profits are between the limits are known as "marginal" companies and will receive "marginal relief". We will look at marginal relief later in this chapter.

Diagrammatically, the rates of corporation tax as they apply for FY 2010 can be shown as follows:



Non-resident companies who are liable to UK corporation tax normally pay tax at the main rate regardless of the level of their augmented profits.

2.2 Augmented profits

The augmented profits are obtained by taking TTP and adding to it dividends received, grossed up at a rate of 100/90. This gross dividend figure is known as **franked investment income** and is commonly shortened to **FII**. CTA 2010, s.32

TTP	**X**
FII = Dividends received x $\frac{100}{90}$	**X**
Augmented profits	**X**

It is the augmented profits figure which we compare with the limits in the tax tables to determine the rate of tax applicable to the particular company, but it is the **TTP which is taxed**.

We only consider **dividends received** in order to determine the **rate** at which the company will pay corporation tax. Dividends received by a UK resident company are not normally charged to corporation tax.
From 1 July 2009 this includes foreign dividends – foreign dividends received prior to this date form part of TTP. Such dividends do not therefore form part of franked investment income.

For the rest of this manual we will assume that all dividends received by UK resident companies after 1 July 2009 are exempt from UK corporation tax.

Furthermore when establishing the augmented profits figure, we only consider **dividends received from non-group companies**. We will look at the definition of non-group companies later.

Illustration 1

Two separate companies, A Ltd and B Ltd make up accounts for the 12 months to 31 March 2011. Their TTPs for the period are:

A Ltd	£200,000
B Ltd	£2,000,000

Both companies receive dividends of £1,800.

To compute each company's CT liability for the year the following method should be used:

1) Calculate the **augmented profits** figure;

2) Consider the **limits** and the **financial year(s)** the chargeable accounting period falls into to determine **which rate** is to be applied to the TTP;

3) Apply the **CT rate to the TTP.**

	y/e 31 March 2011	*y/e 31 March 2011*
	A Ltd	*B Ltd*
	£	£
TTP	200,000	2,000,000
FII £1,800 x 100/90	2,000	2,000
" Augmented Profits"	202,000	2,002,000

The whole chargeable accounting period falls into FY 2010.

Rate to be applied	21%	28%
£200,000 x 21%	£42,000	
£2,000,000 x 28%		£560,000

Remember that the dividends received are **not** taxable income in the hands of a UK resident company, but they are included to decide what **rate** of tax will be payable on the taxable profits (TTP).

2.3 Marginal relief

Marginal relief applies where a company's **augmented profits are between the lower and upper profit limits** of £300,000 and £1.5m. CTA 2010, s.19

In computing the corporation tax liability, **TTP is initially taxed at the main rate of 28%** where profits are between the lower and the upper limits.

Marginal relief is then deducted.

Marginal relief is given by the formula:

$$\textbf{Fraction} \times \textbf{(Upper Limit – Augmented Profits)} \quad \times \quad \frac{\textbf{TTP}}{\textbf{Augmented Profits}}$$

In FY 2010 the fraction is $\frac{7}{400}$ and the marginal relief calculated is deducted from the initial calculation of corporation tax at **28%** to give the actual tax liability.

Illustration 2

C Ltd has the following results for the year to 31 March 2011:

	£
TTP	500,000
FII	80,000
Augmented Profits	£580,000

The augmented profits are between the £300,000 and £1,500,000 limits and marginal relief will apply. The whole chargeable accounting period falls into FY 2010. The tax calculation will be:

	£
£500,000 x 28%	140,000
Less: marginal relief	
$\frac{7}{400} \times (1{,}500{,}000 - 580{,}000) \times \frac{500000}{580000}$	(13,879)
Corporation tax liability	**£126,121**

Where a company has **no FII** and hence TTP and augmented profits are the same, it is acceptable to show the marginal relief formula simply as:

Fraction x (Upper Limit – Augmented Profits)

2.4 Financial Year 2011

The rates of corporation tax applicable for the financial year 2011 (FY 2011), which runs from 1 April 2011 to 31 March 2012, have already been announced by the Chancellor and are included on your tax tables. These rates could therefore be tested in your exam.

In FY 2011 the main rate of tax will be 27%, the small profits rate will be 20% and the marginal relief fraction will remain unchanged at 7/400.

"Augmented Profits"

TTP x 27%	X	
		£1,500,000
TTP x 27%	X	
"Marginal relief"	(X)	
	X	
		£300,000
TTP x 20%	X	

Illustration 3

D Ltd has the following results for the year to 31 March 2012:

	£
TTP	800,000
FII	40,000
Augmented Profits	£840,000

The augmented profits are between the £300,000 and £1,500,000 limits and marginal relief will apply. The whole chargeable accounting period falls into FY 2011.

The tax calculation will be:

	£
£800,000 x 27%	216,000
Less: marginal relief	
$\frac{7}{400} \times (1{,}500{,}000 - 840{,}000) \times \frac{800000}{840000}$	(11,000)
Corporation tax liability	**£205,000**

2.5 Financial Year Straddle

Where the chargeable accounting period straddles 1 April 2011 (e.g. year ended 31 December 2011), part of the profits are charged at the FY 2010 rates and part are taxed at the FY 2011 rates. We therefore need to **time apportion TTP** in order to calculate corporation tax.

There is no need to time apportion either the corporation tax limits or the augmented profits for each financial year, even if the company is marginal, because the marginal relief fraction remains unchanged at 7/400 in both financial years.

Illustration 4

E Ltd has TTP of £8,000 and FII of £1,500 for the year ended 30 June 2011. This year end straddles 1 April 2011 and hence FY 2010 and FY 2011.

	y/e 30 June 2011
	£
TTP	8,000
FII	1,500
Augmented profits	9,500

E Ltd is a small company because the augmented profits are below £300,000.

Nine months of the year ended 30 June 2011 falls into FY 2010 (1 July 2010 to 31 March 2011) and three months fall into FY 2011 (1 April 2011 to 30 June 2011).

To calculate the corporation tax liability we apportion the TTP as follows:

	Total	*FY 2010*	*FY 2011*
		9/12	3/12
	£	£	£
TTP	8,000	6,000	2,000
Small profits rate of tax		21%	20%
Corporation tax liability:			
£6,000 x 21% / £2,000 x 20%		1,260	400
Corporation tax liability		**£1,660**	

We could have reached the same answer by considering the company's **average rate of tax.** The company will pay tax at 21% for the first nine months and 20% for the remaining three months. The average rate of tax is:

9/12 x 21%	15.75%
3/12 x 20%	5.00%
Average rate	20.75%

If we apply 20.75% to the TTP we get £8,000 x 20.75 % = £1,660

Illustration 5

F Ltd has TTP of £750,000 and FII of £15,000 for the year ended 31 December 2011. This year end straddles FY 2010 and FY 2011.

	y/e 31 December 2011
	£
TTP	750,000
FII	15,000
Augmented profits	765,000

The total augmented profits for the year ended 31 December 2011 are between the £300,000 and £1,500,000 limits and marginal relief will apply.

The chargeable accounting period falls into both FY 2010 and FY 2011, therefore we just time apportion the TTP as follows:

	Total	*FY 2010*	*FY 2011*
		3/12	9/12
	£	£	£
TTP	750,000	187,500	562,500
Main rate of tax		28%	27%
Corporation tax liability:			
£187,500 x 28% / £562,500 x 27%		£52,500	£151,875

$$\underbrace{£52{,}500 \quad £151{,}875}_{204{,}375}$$

Less marginal relief:

$$\frac{7}{400} \times (1{,}500{,}000 - 765{,}000) \times \frac{750000}{765000} \qquad (12{,}610)$$

Corporation tax liability **£191,765**

If a chargeable accounting period straddles financial years where the corporation tax rates are the same in both financial years, no time apportionment of TTP is required. This will be the case where a chargeable accounting period straddles financial years 2009 and 2010.

Example 1

Consider the following companies with a year end of 31 March 2011:

	X Ltd	Y Ltd
	£	£
TTP	1,400,000	280,000
Dividends received	100,000	16,200

Calculate the corporation tax liability for each company.

Example 2

G Ltd has the following results for the year ended 31 March 2011:

	£
Trade profit	250,000
UK property business	60,000
Chargeable gain	180,000
Dividends received	18,000

Calculate the corporation tax liability for G Ltd.

Example 3

Consider the following companies with a year end of 30 September 2011:

	R Ltd	S Ltd
	£	£
TTP	1,200,000	130,000
Franked investment income	80,000	10,000

Calculate the corporation tax liability for each company.

Answer 1

	X Ltd	Y Ltd
	£	£
TTP	1,400,000	280,000
FII (dividends x $\frac{100}{90}$)	111,111	18,000
Augmented profits	£1,511,111	£298,000
	> 1.5m limit	< £300k limit
Tax rate	28%	21%
Corporation tax liability: (TTP x rate)		
£1,400,000 x 28%	**£392,000**	
£280,000 x 21%		**£58,800**

Answer 2

	G Ltd
	£
Trade profit	250,000
UK property business	60,000
Chargeable gain	180,000
TTP	490,000
FII (dividend x $\frac{100}{90}$)	20,000
Augmented profits	£510,000
	Between limits so marginal
Corporation tax liability:	£
£490,000 x 28%	137,200
Less marginal relief: $\frac{7}{400}$ x (1,500,000 – 510,000) x $\frac{490000}{510000}$	(16,646)
Corporation tax liability	**£120,554**

Answer 3

R Ltd	*y/e 30 September 2011*
	£
TTP	1,200,000
FII	80,000
Augmented profits	1,280,000

The total augmented profits for the year ended 30 September 2011 are between the £300,000 and £1,500,000 limits and marginal relief will apply.

Although the chargeable accounting period falls into both FY 2010 and FY 2011 there is no need to time apportion either the corporation tax limits or the augmented profits for each financial year. This is because the marginal relief fraction remains unchanged at 7/400 in both financial years.

Therefore we just time apportion the TTP as follows:

	Total	*FY 2010*	*FY 2011*
		6/12	6/12
	£	£	£
TTP	1,200,000	600,000	600,000
Main rate of tax		28%	27%

Corporation tax liability:

$$\underbrace{£168{,}000 \quad £162{,}000}_{330{,}000}$$

£600,000 x 28% / £600,000 x 27%: £168,000 / £162,000 = 330,000

Less marginal relief:

$$\frac{7}{400} \times (1{,}500{,}000 - 1{,}280{,}000) \times \frac{1200000}{1280000} \qquad (3{,}609)$$

Corporation tax liability **£326,391**

S Ltd	*y/e 30 September 2011*
	£
TTP	130,000
FII	10,000
Augmented profits	140,000

S Ltd is a small company because the augmented profits are below £300,000.

However, because the chargeable accounting period falls into both FY 2010 and FY 2011, to calculate the corporation tax liability we apportion the TTP as follows:

		FY 2010	*FY 2011*
	Total	*6/12*	*6/12*
	£	£	£
TTP	130,000	65,000	65,000
Rate of tax		21%	20%
Corporation tax liability:			
£65,000 x 21% / £65,000 x 20%		£13,650	£13,000
Corporation tax liability		**£26,650**	

Corporation Tax Act 2010 – New Terminology

Old terminology	**New terminology**
Profits chargeable to corporation tax (PCTCT)	Taxable total profits (TTP)
Franked investment income (FII)	Franked investment income (FII) (unchanged)
Notional profits	Augmented profits (AP)
Small companies rate	Small profits rate
Charges on income	Qualifying charitable donations
Full rate	Main rate