CHAPTER 6

LONG PERIODS OF ACCOUNT

6.1 Introduction

A chargeable accounting period **(CAP)** for corporation tax **cannot exceed 12 months**. However, under company law, accounts can be drawn up for periods as long as 18 months. The period for which accounts are made up is known as the period of account (POA). CTA 2009, s.10 (1)(a)

Where a period of account **exceeds 12 months**, it must be **split into two** separate CAPs for tax purposes. The first will be the **first 12 months,** because a CAP cannot exceed 12 months. The second will be the **balance of the period**, because a CAP always ends when a period of account ends.

Illustration 1

Longton Limited makes up a set of accounts for the 16 months ended 31 July 2010.

The period of account begins on 1 April 2009 and so therefore, the first CAP will run through to 31 March 2010.

The second CAP will start immediately afterwards on 1 April 2010 and will run through to the end of the period of account on 31 July 2010.

In summary the two CAPs will be:

CAP 1: 1 April 2009 to 31 March 2010 (12 months)
CAP 2: 1 April 2010 to 31 July 2010 (remaining 4 months)

6.2 Preparing the corporation tax returns

Once we have worked out the chargeable accounting periods, we **then split the company's income between the two separate CAPs**, as the accounts will have been drawn up showing profits for the entire period of account.

We need to calculate trade profit. **Trading profits are adjusted for the entire period of accounts** by adding back disallowed items, such as client entertaining and depreciation and deducting income that is not taxed as trading income, such as bank interest receivable and property income. The resulting **tax adjusted trading profits before deducting capital allowances are then time apportioned between the two CAPs.**

Next we calculate capital allowances. As far as **capital allowances** are concerned, we have to prepare **separate computations for each CAP** taking account of additions and disposals in each separate CAP. We claim a separate writing down allowance for each of the two CAPs.

The **writing down allowance and the annual investment allowance limit are time apportioned** for the second CAP because it is a short CAP, but remember that any **first year allowances are never time apportioned.**

We then calculate the TTP and augmented profits for each CAP.

Non trading profits (loan relationships) and UK property business income are split on a time apportionment basis as the accruals basis of accounting applies to these sources of income.

We must be careful with the time apportionment of non-trading profits (loan relationships) and UK property business income where the source is acquired part way through the CAP. In this case, we must time apportion the income over the period in which it arose, rather than for the entire accounting period.

Management expenses for an investment company are split on an accruals basis.

Chargeable gains are split between the two separate CAPs based on the **date of disposal** of the asset. This is the date of a binding contract of sale, which for property is the date of **exchange** of contracts.

We deduct qualifying charitable donations**,** which are split between the CAPs based on the **date** that the donation was actually **paid,** to give us TTP**.**

Franked investment income **is split between the** CAPs based on the date of receipt of the dividend**.** This is added to TTP to give augmented profits for each CAP.

Finally, **two separate computations of the corporation tax liability are then prepared, one for each CAP**. The second CAP will be less than 12 months so the corporation tax limits must be time apportioned.

Illustration 2

Longton Limited prepares accounts for the 16 months ended 31 July 2010. Results for the period are as follows:

	£
Gross profit	640,000
Bank interest receivable	8,000
Rental income	14,000
Profit on sale of fixed asset	7,000
Dividends received	9,000
Expenditure:	
Wages and salaries	(150,000)
Depreciation expense	(58,000)
Donation to charity	(2,000)
Sundry expenses	(10,000)
Profit before tax	458,000

Notes:

1. The rental property was acquired on 1 January 2010 and has been rented out since that date.
2. The dividends were received from a non-associated company on 1 January 2010.
3. The fixed asset was sold on 30 May 2010. This gave rise to a chargeable gain of £10,000.
4. A donation of £1,000 per annum is paid to charity on 1 July each year.
5. The general pool had a tax written down value of £30,000 at 1 April 2009. The following additions and disposals were made during the period:

Additions:	Machine	1.1.10	£8,000
	Computer	1.6.10	£2,400
Disposal:	Plant	1.7.10	£(3,000)

6. Longton Limited had one wholly owned subsidiary which was sold on 1 February 2010. The subsidiary had not incurred any capital expenditure in the last two accounting periods.

We have already identified **the two CAPs** relating to this 16 month period of accounts in illustration 1. They are:

CAP 1: 1 April 2009 to 31 March 2010 (12 months)
CAP 2: 1 April 2010 to 31 July 2010 (remaining 4 months)

Next we start with the profit before tax of £458,000 **and perform all of our tax adjustments for the 16 month period** to give us the tax adjusted trading profits before capital allowances for the 16 months to 31 July 2010.

		£
Profit before tax per accounts		458,000
Add back:	Depreciation expense	58,000
	Donation to charity	2,000
Less:	Bank interest receivable	(8,000)
	Rental income	(14,000)
	Profit on sale of fixed asset	(7,000)
	Dividends received	(9,000)
Tax adjusted trading profits before capital allowances for 16 months to 31 July 2010		480,000

These tax adjusted trading profits before capital allowances are then time apportioned between the two CAPs:

	y/e 31.3.10	4 m/e 31.7.10
	£	£
Tax adjusted trading profit before capital allowances	360,000	120,000
$£480,000 \times \frac{12}{16}$ and $\frac{4}{16}$		

The next step is to calculate the capital allowances separately for each CAP.

	AIA @ 100%	*General Pool*	*Allowances*
Y/e 31.3.10	£	£	£
Tax WDV b/f at 1.4.09		30,000	
Addition:			
Machine 1.1.10	8,000		
AIA @ 100%	(8,000)		8,000
WDA @ 20%	______	(6,000)	6,000
			£14,000
Tax WDV c/f at 31.3.10	nil	24,000	
4 m/e 31.7.10			
Tax WDV b/f at 1.4.10		24,000	
Addition:			
Computer 1.6.10	2,400		
AIA @ 100%	(2,400)		2,400
Disposal: Plant 1.7.10	______	(3,000)	
		21,000	
WDA @ 20% $\times \frac{4}{12}$		(1,400)	1,400
			£3,800
Tax WDV c/f at 31.7.10	nil	19,600	

The WDA has been time apportioned in the second CAP. The annual investment allowance limit is also time apportioned as £100,000 x 4/12 = £33,333 but because this exceeds £2,400, 100% relief is given on the cost of the computer in the second CAP.

We can now calculate the trade profit for each CAP as follows:

	y/e 31.3.10	4 m/e 31.7.10
	£	£
Tax adjusted trading profit before capital allowances	360,000	120,000
Less: capital allowances	(14,000)	(3,800)
Trade profit	346,000	116,200

We can now prepare the corporation tax computations and calculate the TTP and augmented profits for each CAP. Remember that non-trading profits (LRs) and UK property business income are time apportioned between CAPs on an accruals basis, chargeable gains are allocated based on the date of disposal and donations to charity are allocated based on the date of payment.

Care must be taken with respect to the apportionment of property income. The rental property was first rented out on 1 January 2010. The rental income of £14,000 therefore arose over a 7 month period from 1 January 2010 to 31 July 2010. Three months of the rents are accrued in the first CAP and four months are accrued in the second CAP.

Dividends received are allocated based on the date of receipt.

	y/e 31.3.10	4 m/e 31.7.10
	£	£
Trade profit (as above)	346,000	116,200
Non-trading profits (LR)(£8,000 x $\frac{12}{16}$ and $\frac{4}{16}$)	6,000	2,000
UK property business income		
1.1.10 – 31.3.10 (£14,000 x $\frac{3}{7}$)	6,000	
1.4.10 – 31.7.10 (£14,000 x $\frac{4}{7}$)		8,000
Chargeable gain (date of disposal 30.5.10)		10,000
Qualifying charitable donations (paid basis)		
- paid 1 July 2009/ 1 July 2010	(1,000)	(1,000)
TTP	357,000	135,200
FII (£9,000 x 100/90 – rec'd 1.1.10)	10,000	0
Augmented profits	367,000	135,200

Finally we calculate the corporation tax liability for each chargeable accounting period.

We must compare the augmented profits for each CAP to the corporation tax limits to determine the rate of tax to apply to the TTP.

In the 12 months ended 31 March 2010 Longton Ltd has one associated company which is sold during the CAP so the limits need to be divided by two. In the four months to 31 July 2010 Longton Ltd has no associated companies but the limits need to be time apportioned for the short CAP.

Profit Limits:		y/e 31.3.10	4 m/e 31.7.10
Upper limit	$\frac{1500000}{2}$ / $1{,}500{,}000 \times \frac{4}{12}$	£750,000	£500,000
Lower limit	$\frac{300000}{2}$ / $300{,}000 \times \frac{4}{12}$	£150,000	£100,000

In the 12 months ended 31 March 2010 the company is marginal because the augmented profits of £367,000 are between £150,000 and £750,000. The whole CAP falls in FY 2009.

In the four months ended 31 July 2010 the company is also marginal because the augmented profits of £135,200 are between £100,000 and £500,000. The whole CAP falls in FY 2010.

	y/e 31.3.10	4 m/e 31.7.10
	£	£
Corporation tax liability:		
£357,000 x 28%	99,960	
£135,200 x 28%		37,856
Marginal Relief:		
$\frac{7}{400} \times (750{,}000 - 367{,}000) \times \frac{357000}{267000}$	(6,520)	
$\frac{7}{400} \times (500{,}000 - 135{,}200)$		(6,384)
Corporation tax liability	**£93,440**	**£31,472**

As we shall see later, these **two separate CT liabilities are paid at different times** so there is never any point in adding them together.

It is also possible for a company to pay tax at different rates for the two periods. For example, a company could pay tax at the small profits rate in the first (12 month) CAP, but then pay tax at the main rate in the other (short) CAP if, for example, a large capital gain fell into this latter period.

Example 1

Smith Ltd makes up its accounts for the 18 months to 30 June 2010. It owns 60% of the shares of Hague Ltd.

Smith Ltd has the following income and expenditure for the period:

Tax adjusted trading profit before capital allowances	£240,000
Rental income £12,000 per annum, increasing to £15,000 per annum from 1 January 2010	£19,500
Bank interest (accruing evenly throughout the period)	£3,600
Chargeable gain on disposal on 14 May 2010	£110,000
Dividend received on 14 September 2009 from a non-associated company	£9,000
Donations to charity:	
- paid 1 May 2009	£20,000
- paid 1 May 2010	£24,000

The capital allowances for the 12 months ended 31 December 2009 are £31,000 and for the 6 months ended 31 June 2010 are £14,300.

You are required to calculate the corporation tax liability for each chargeable accounting period.

The rates for FY 2008 were the same as FY 2009 and FY 2010.

Answer 1

Computation of corporation tax liability:

	12 months to 31.12.09	*6 months to 30.6.10*
	£	£
Tax adjusted trading profit before capital allowances (£240,000 x 12/18 and 6/18)	160,000	80,000
Less: Capital Allowances (given)	(31,000)	(14,300)
Trade profit	129,000	65,700
UK property business (£12,000/ £15,000 x 6/12)	12,000	7,500
Non-trading profit (LR) (£3,600 x 12/18 and 6/18)	2,400	1,200
Chargeable gain (disposal 14 May 2010)		110,000
	143,400	184,400
Less: Qualifying charitable donations - paid 1 May 2009/ 1 May 2010	(20,000)	(24,000)
TTP	123,400	160,400
FII (£9,000 x 100/90 – rec'd 14 Sep 2009)	10,000	Nil
Augmented profits	133,400	160,400
Corporation tax liability: (W) £123,400 x 21%	**£25,914**	
£160,400 x 28%		44,912
Less marginal relief: $\frac{7}{400}$ x (375,000 – 160,400)		(3,756)
Corporation tax liability		**£41,156**

(W) Tax rates

	12 months to 31.12.09	*6 months to 30.6.10*
	£	£
Augmented profits	133,400	160,400
Profit limits:		
Upper limit: £1,500,000/2 / £1,500,000/2 x 6/12	£750,000	£375,000
Lower limit: £300,000/2 / £300,000/2 x 6/12	£150,000	£75,000
	Small	Marginal