CHAPTER 21

CORPORATE CAPITAL GAINS

21.1 Introduction

A **company pays corporation tax on capital gains** arising on the disposal of chargeable assets. Most capital assets are chargeable with a number of minor exceptions, e.g. cars. The definition of a car does not extend to vans and other commercial vehicles which may give rise to chargeable gains where they are sold at a profit.

Individuals pay capital gains tax (CGT) at a flat rate of 18% or 28% depending on the level of their total taxable income, on disposals, whereas companies include the gains as part of their TTP and so pay corporation tax on gains at their marginal rate.

The rules for computing gains for companies are similar to the rules that apply to individuals. However, **companies continue to claim indexation allowance** whereas individuals no longer can. Companies are **not entitled to an annual exemption** and are **not eligible for entrepreneurs' relief.**

21.2 Computation of gains

The pro forma for computing gains for a company is shown below. **We start with sale proceeds** from which we can **deduct any incidental costs of sale** such as solicitor's or surveyor's fees, etc.

We **deduct the cost of the assets** which will also **include any enhancement expenditure and other incidental costs of acquisition** including legal fees and stamp duty paid. That gives us the **unindexed gain**.

We then **deduct indexation allowance**, which is an allowance for inflation, to give the **indexed gain**. It is this indexed gain that is subject to corporation tax.

Capital Gains proforma for a company

	£	£
Proceeds		X
Less: incidental selling costs		X
		X
Less:		
Cost	X	
Incidental costs of acquisition	X	
Enhancement expenditure	X	
		(X)
Unindexed gain		X
Less: indexation allowance		(X)
Indexed gain		X

Illustration 1

Viscount Ltd sold a factory for £1,200,000 on 30 September 2010. Solicitor's fees amounted to £2,000. The factory had been purchased in May 1994 at a cost of £350,000.

The capital gain will be computed as follows:

	£
Proceeds	1,200,000
Less incidental selling costs	(2,000)
	1,198,000
Less: cost	(350,000)
Unindexed gain	848,000
Less: indexation (£350,000 at, say, 50%)	(175,000)
Indexed gain	**£673,000**

21.3 Indexation allowance

The indexation factor is calculated by taking the movement in the **Retail Price Index** (RPI) **between the date of acquisition of the asset and the date of sale.**

The RPIs are given in the tax tables accompanying this course.

The indexation factor is computed using the formula:

$$\frac{\textbf{RPI at sale – RPI at acquisition}}{\textbf{RPI at acquisition}}$$

The result of this is **rounded to three decimal** places using normal mathematical rounding (or can be expressed as a percentage).

We then **multiply cost by the indexation factor**.

Illustration 2

In the previous illustration, Viscount Ltd, we assumed the indexation factor was 50%.

The correct indexation factor for May 1994 to September 2010 is:

$$\frac{227.9 - 144.7}{144.7} = 0.5749927 = 0.575$$

The correct gain is therefore:

	£
Unindexed gain	848,000
Less: indexation (£350,000 x 0.575)	(201,250)
Indexed gain	**£646,750**

If the value of the RPI has fallen between acquisition and disposal, then indexation allowance is nil.

21.4 Enhancement expenditure

Enhancement expenditure is added to the "base cost", or allowable cost, of the asset. It may need to be **indexed separately** if the enhancement occurs at a different date to that of the acquisition of the asset.

Illustration 3

Assume in the Viscount Ltd illustration that the factory was extended in October 1998 at a cost of £200,000. For simplicity we will ignore the incidental selling costs now, so we have proceeds of £1,200,000 and original cost of £350,000.

	£
Proceeds (Sept 2010)	1,200,000
Less: cost (May 1994)	(350,000)
Less: enhancement (Oct 1998)	(200,000)
Unindexed gain	650,000
Less: indexation on cost May 1994 to Sept 2010 $\frac{227.9 - 144.7}{144.7}$ = 0.575 x £350,000	(201,250)
Less: indexation on enhancement Oct 1998 to Sept 2010 $\frac{227.9 - 164.5}{164.5}$ = 0.385 x £200,000	(77,000)
Indexed gain	**£271,750**

21.5 Capital losses

Capital losses are computed in the same way as capital gains, except that **indexation cannot create or increase a capital loss**, it can only reduce a gain to zero.

Illustration 4

Using the Viscount Ltd illustration again, but this time, lets assume that the asset was actually sold for just £400,000. So, Viscount Ltd sells a factory for £400,000 on 30 September 2010 and had originally purchased the factory in May 1994 at a cost of £350,000.

	£
Proceeds	400,000
Less: cost	(350,000)
Unindexed gain	50,000
Less: indexation allowance: £350,000 x 0.575 = £201,250 (restricted)	(50,000)
Indexed gain	**Nil**

Indexation allowance is claimed, **but restricted** to the amount of the unindexed gain as it **can not create a loss**. Hence, the indexed gain, after the indexation allowance, is nil.

Illustration 5

Assume now that the asset was actually sold by Viscount Ltd for just £250,000. The original acquisition cost is still £350,000.

	£
Proceeds	250,000
Less: cost	(350,000)
Allowable capital loss	**£(100,000)**

No indexation is claimable as it cannot increase this loss.

The capital loss may be **utilised against capital gains in the same year**, or carried forward against **future chargeable gains.**

21.6 Assets purchased before 31 March 1982

Where the asset was originally acquired before 31 March 1982, we are required to do an additional calculation to compute the capital gains and losses for companies.

The additional calculation starts in the same place i.e. with sales proceeds. However, instead of deducting original cost, we deduct the **value of the asset as at 31 March 1982.**

In effect we are pretending that we bought the asset on 31 March 1982 for its value at that date. This gives us the gross gain from which we can deduct indexation allowance to arrive at the indexed gain.

We compare this calculation based on the value of the asset at 31 March 1982 with the normal capital gain calculation based on cost. Consequently, if the value of the asset has risen from the time of purchase to March 1982, it will be advantageous to use the March 1982 value.

We will **prepare two calculations;** one based on cost and one based on the March 1982 value.

Where this produces **two gains**, we **take the lower gain**.

If this gives us **two losses**, we take the **lower loss.**

Where we produce **one gain** and **one loss**, the answer will be **nil.**

Indexation allowance **runs from March 1982 and is based on the higher of the cost or March 1982** value in **both** calculations. A full proforma is shown at the end of the chapter.

It is possible for companies to make a "**global rebasing election**". A global rebasing election means that the company will **elect for all capital gains** on pre 1982 assets to be **calculated by reference to the March 1982 value** instead of cost. TCGA 1992, s.35

This means that **only one calculation** will be performed – that being the one **using March 1982 value**.

A global rebasing election is **irrevocable** and **applies to all assets** held by the company at 31 March 1982. The election must be in writing and the time limit for the election is the **two years from the end of the first chargeable accounting period** in which a **pre 1982 asset is sold**. For most companies this time limit is likely to have already been passed. SP 4/92

The main advantage of making a global rebasing election is for **administrative convenience** – i.e. it takes away the need for the company to ascertain the original acquisition cost. A rebasing election can also give a company **access to higher capital losses.**

Illustration 6

Ventura Limited purchased a factory in June 1970 for £80,000. It was worth £170,000 on 31 March 1982. The factory is sold in September 2010 for £550,000.

	Cost	March 1982
	£	£
Proceeds	550,000	550,000
Less: cost/March 1982 value	(80,000)	(170,000)
Unindexed gain	470,000	380,000
Less: indexation		
March 1982 to September 2010		
On higher of cost or March 1982 value		
$\frac{227.9 - 79.44}{79.44}$ = 1.869 x £170,000	(317,730)	(317,730)
Indexed gain	**£152,270**	**£62,270**

Indexation will run from March 1982 to September 2010 (date of sale) on the 31 March 1982 value of £170,000, being the **higher** of cost or March 1982 value, for **both** calculations.

As the **two columns both produce capital gains, the lower gain is taken** i.e. £62,270. £62,270 will be included in Ventura Limited's TTP and charged to corporation tax.

Illustration 7

Using the Ventura Limited illustration again, lets now assume that instead the asset was sold for £450,000. Original cost is still £80,000 and the value at 31 March 1982 is £170,000.

	Cost	March 1982
	£	£
Proceeds	450,000	450,000
Less: cost	(80,000)	(170,000)
Unindexed gain	370,000	280,000
Less: indexation: 1.869 x £170,000	(317,730)	(280,000)*
Indexed gain	**£52,270**	**nil**

* The indexation is restricted so as not to produce a loss.

The **lower amount** is taken i.e. nil.

21.7 Rollover relief

Where a company sells one qualifying asset and purchases another qualifying asset, within a specified period, the **gain on the sale of asset 1** can be **deducted from the base cost of asset 2** upon the company making an election. This will ensure that the company does not pay corporation tax on the gain arising at the time of the sale of the first asset. TCGA 1992, s.152

The effect of the rollover relief claim is to defer the gain on the sale of asset 1. By reducing the base cost of asset 2, a larger gain will arise on its subsequent sale.

These rules only apply when the company is selling **assets used for the purposes of a trade**. The Government is keen to encourage companies to reinvest in their trading activities without having to pay corporation tax on gains along the way. TCGA 1992 s.152(1)

Eligible assets include:

(i) **Land and buildings** (used in the trade); TCGA 1992, s.155

(ii) Goodwill bought or created prior to April 2002;

(iii) **Fixed plant and machinery** - "Fixed" means bolted to the floor or building.

Goodwill bought or created after 1 April 2002 is not within the capital gains regime as explained in the chapter on Intangible Fixed Assets. In addition, a gain on goodwill that is within the capital gains regime can only be rolled over in respect of the purchase of an intangible fixed asset.

The **specified period** during which asset 2 must be purchased, is **one year before the disposal of asset 1 to three years afterwards.** TCGA 1992, s.152(3)

The company must claim **within 4 years (post 1 April 2010, previously 6 years) of the end of the chargeable accounting period** of the disposal of asset 1.

21.8 The 50% rule

The "50% rule is a slightly strange rule introduced in 1988, as a means of giving rebasing relief for assets acquired before March 1982 for which rollover relief is claimed. The "50% rule" applies if **three specific conditions** have been satisfied: TCGA 1992, Sch 4

1. The company must have **acquired an asset before March 1982.** TCGA 1992, Sch 4 Para 2

2. The asset must have been **sold by the company between March 1982 and 5 April 1988.**

3. Having made the disposal, the company must have **claimed rollover relief**, so that all or part of the original gain is rolled over and reduces the base cost of the replacement asset.

If all three conditions are satisfied, the **gain rolled over** against the base cost of the replacement asset is not the whole of the original gain, but is **only 50% of that gain**. By rolling over a smaller amount, we are increasing the base cost of the replacement asset and thereby reducing the eventual capital gain when the replacement asset is sold.

Illustration 8

A company bought a building for £20,000 in June 1980. The company sells the building for £50,000 in May 1986. The gain is calculated by taking proceeds less cost less indexation allowance. Indexation accrues between March 1982 and the date of sale in May 1986. In calculating this capital gain, we **have not deducted the March 1982 value instead of cost, because the rebasing rules were not introduced until April 1988.**

	£
Proceeds	50,000
Less: cost	(20,000)
Less: indexation (March 1982 - May 1986)	
£20,000 x 0.232	(4,640)
	£25,360

In June 1986, the company reinvested the sales proceeds in acquiring a replacement building costing £80,000. **The whole of the sales proceeds from the first disposal have been reinvested in acquiring a replacement asset, so the whole of the gain of £25,360 can be rolled over**.

However, because we have a pre-1982 asset, which was **sold between 1982 and 1988** and a rollover relief claim has been made, what is rolled over is not all of the gain of £25,360, but only **50%** of it.

	£
Cost	80,000
50% of rolled-over gain	(12,680)
Base cost of replacement asset	**£67,320**

Building number 2 is sold in for £200,000 in September 2010. Building number 2 is treated as having been bought in June 1986 for its revised base cost of £67,320. Indexation runs from June 1986 until September 2010, giving a gain of:

	£
Proceeds	200,000
Less: cost	(67,320)
Less: indexation allowance	
1.331 x £67,320	(89,603)
Gain	**£43,077**

This "50% rule" can be difficult to spot. **Only 50% of the gain will be rolled over, where:**

i. **a pre-1982 asset;**
ii. **is sold between 1982 and 1988; and**
iii. **the gain is deferred.**

21.9 Group wide rollover relief

A **"group" of companies** is regarded as **one unit for rollover relief** purposes. This means that if one company in a group – "company A" – sells an asset and a replacement asset is acquired by another company in the same group – "company B" – the gain made by company A can be rolled over and deducted from the base cost of the asset in company B.

In simple terms, a "group" of companies will exist where one company owns at least **75%** of the shares of another.

21.10 Disposal of substantial shareholding

Disposals by a company of "substantial shareholdings" in other companies are **exempt from tax**. Consequently, gains are not taxable and losses are not allowable when dealing with disposals of substantial shareholdings. The rules apply to shareholdings in both UK resident and non-resident companies.

A substantial shareholding is defined as **10% or more** of a company's ordinary share capital. The ordinary shares held must also give entitlement to at least 10% of the company's distributable profits **and** 10% of assets on a winding up. For these purposes, the holdings of other group members are taken into account.

To qualify:

(i) A substantial shareholding must have been held for **at least 12 months** in a period beginning not later than two years before the sale takes place;

(ii) the investing company must either be a sole trading company or the member of a trading group;

(iii) the shares must be in a qualifying company which is a defined as a trading company or a member of a trading group;

Conditions (ii) and (iii) must apply in the latest 12 month period in which the substantial shareholding test has been satisfied and ending with the time of the disposal AND immediately following the disposal.

These rules are covered in more detail in a later chapter.

21.11 Paper for paper exchanges

The rules for companies are essentially the same as for individuals. Where **shares or non qualifying corporate bonds** are received we use the **no disposal** fiction. If cash is received as well as securities then there will be a disposal and indexation will be available. TCGA 1992, s.116 (10)

Where **shares are replaced by QCBs** in a reorganisation then the shares are treated as though they had been disposed of at market value and the resulting **gain or loss is then deferred** and only recognised on the disposal of the QCBs. In the meantime, the QCBs are subject to the normal **loan relationship rules.** TCGA 1992, s.116 (8A)

However, where under a s.135 TCGA 1992 or s.136 TCGA 1992 reorganisation a **QCB** (i.e. a loan relationship) is **replaced by shares or other QCBs** then there is no deferral of the gain or loss and there is an immediate recognition. The **gain or loss is brought into the loan relationship provisions.** TCGA 1992, s.116 (9)

The assumption made in s.127 TCGA 1992 of there being no disposal and the new holding being treated as the acquisition of the old holding is not applied .The new asset of shares or securities is treated as being effectively **acquired at market value**.

This is to be contrasted with the treatment under s.132 TCGA 1992 of a QCB which is converted into shares in the same company, or into a debt on a security in the same company which is not a QCB. In this case the original security is not deemed to have been disposed of, i.e. the rules in s.127 TCGA 1992 are applied. Only when the shares or new securities are disposed of will any gain or loss be recognised. Similar treatment is applied to a non QCB which is converted into shares of the same company or a QCB.

21.12 Anti-avoidance

FA 2006 introduced new anti-avoidance measures aimed at preventing companies using tax planning schemes which involved buying capital losses or capital gains, converting income into capital or securing a tax deduction. These rules are commonly referred to as the Targeted Anti-Avoidance Rules or TAARs. The legislation is found in s.184A- s.184H TCGA 1992 and is covered further in a later chapter.

NB	Further details regarding the calculation of chargeable gains and the operation of rollover relief can be found in your Capital Gains Tax material. You should also note that the share pooling rules for companies differ to those for individuals in the CGT manual however, they are not in the syllabus.

Example 1

Cresta Ltd purchased a warehouse in May 1990 for £425,000 and incurred solicitor's and surveyor's fees on this purchase amounting to £2,000. Stamp Duty Land Tax was charged at 3% on the purchase price and this was payable by Cresta Ltd. The warehouse is sold in January 2011 (RPI 233.5) for £1.5 million and solicitor's fees of £3,000 were incurred.

You are required to calculate the indexed chargeable gain.

Answer 1

		£	£
Proceeds		1,500,000	
Less: incidental costs		(3,000)	
Net sale proceeds			1,497,000
Less:			
Cost		425,000	
Incidental costs		2,000	
Stamp duty land tax	(£425,000 x 3%)	12,750	
			(439,750)
Unindexed gain			1,057,250
Less: indexation			
May 1990 to January 2010			
$\frac{233.5 - 126.2}{126.2}$	= 0.850 x £439,750		(373,788)
Indexed gain			**£683,462**