

# FL MEMO

## Corporation Tax

2011-2012

EXTRACTS



# Contents

## Part 1: Scope

- 10 Basic outline
- 50 Who is liable
- 100 What is liable

## Part 2: Business activity

- 400 Trading
- 500 Investment business
- 580 Dormant companies

## Part 3: Chargeable profits

- 700 Overview
- 760 Accounting profits
- 970 Capital or revenue
- 1080 Trading income and expenditure
- 1320 Financial income and expenditure
- 1720 Distributions
- 1900 Property income
- 2210 Sundry items including anti-avoidance

## Part 4: Holding of assets

- 2800 Acquiring and holding tangible fixed assets
- 3500 Acquiring and holding intangible fixed assets
- 3850 Disposals

## Part 5: Losses

- 4520 Types and interaction
- 4550 Revenue losses
- 4800 Capital losses

## Part 6: Calculation of the tax charge

- 5000 Computation
- 5150 Adjustments to tax liability

## Part 7: Compliance

- 5700 Records
- 5800 Reporting
- 6030 Payment and repayment

Part 8: Enforcement
---------------------

- 6150 Powers
- 6350 Interest levied
- 6400 Penalties
- 6610 Clearances, reviews and appeals

Part 9: Starting and ceasing a company
--

- 6800 Starting a business
- 6905 Ceasing a business

Part 10: Groups and consortia
-------------------------------

- 7000 Forming a group or consortium
- 7140 Loss relief
- 7300 Chargeable gains
- 7500 Special situations
- 7680 Transfer pricing

Part 11: Particular situations
--------------------------------

- 7800 Close companies
- 8050 Trading through an intermediary
- 8150 Research and development
- 8300 Reconstructions and mergers
- 8450 Attracting third party investment
- 8600 The leasing industry
- 8750 The farming industry

Part 12: Cross-border issues
------------------------------

- 9200 Investing overseas
- 9520 Inward investment
- 9670 European companies
- 9780 Arbitrage

General information
---------------------

- 9960 Appendix
- 9999 Table of cases
- Index

## CHAPTER 1

## Trading

OUTLINE		₹₹
SECTION 1 <b>Definition</b> .....	405	
Profession .....	407	
Influence of case law .....	410	
SECTION 2 <b>Badges of trade</b> .....	420	
Summary.....	422	
1 Nature of the asset.....	424	
2 Period of ownership .....	432	
3 Frequency and number of transactions.	434	
4 Changes made to the asset.....	440	
5 How was the sale carried out?.....	442	
6 Profit seeking motive .....	450	
7 Method of acquisition .....	458	
8 Source of finance.....	460	
9 Existence of similar trading transactions	462	
10 Mutual trading.....	464	
SECTION 3 <b>Specified activities</b> ...	475	
Betting and gambling .....	477	
Illegal activity.....	482	

400

Most of the time, it will be obvious whether a company is carrying on a trade. Indeed, the question of whether a trade exists is essentially one of fact. For this purpose, a professional activity is treated the same as trading.

However, it may be less clear cut when unusual activities are undertaken, or losses are sustained without any future prospect of a profit.

If a trade is not present, it is necessary to consider whether any investment activity is undertaken (₹500), or whether the company is actually dormant (₹580).

## SECTION 1

## Definition

405

s 1119 CTA 2010

Although statute only says that the term “trade” includes any venture in the nature of trade, this actually has a very wide scope, which would include:

- an isolated transaction *CIR v Fraser* [1942]; or
- a speculative adventure that yields an unexpected profit. *Wisdom v Chamberlain* [1968]

Trade must be used in its ordinary dictionary sense. *Smith Barry v Cordy* [1946]

It is often used to denote operations of a commercial character by which the trader provides to customers as a reward for some kind of goods or services. *Ransom v Higgs* [1974]

Whether the trade is intended to be **profitable**, or indeed ever makes a profit, is usually irrelevant (₹450).

**Comment** Before the law was rewritten, statute referred to every trade, manufacture, adventure or concern in the nature of trade.

## Profession

Statute does not define profession, but the term **indicates** an occupation requiring intellectual skill e.g. architect or a controlled manual skill e.g. sculpturing. So incorporated firms of lawyers, accountants, surveyors etc will be liable to corporation tax in the same way as a normal trading company.

**Comment** The rewritten law does not mention profession as it was deemed unlikely that a company would be carrying on a profession or vocation.

407

s 35 CTA 2009

## Influence of case law

HMRC state that the following **conclusions** can be drawn from case law:

- trade cannot be precisely defined;
- certain characteristics can be identified which are normally those of a trade; and
- other characteristics can be found which preclude a profit from being that of a trade.

Case law is a fruitful source of principle, although care should be taken when comparing facts between a particular situation and settled case law, as there will be inevitable distinguishing factors which may themselves lead to a different conclusion.

410

BIM 20051

## SECTION 2

### Badges of trade

The approach of the courts has been to examine the facts and look for the presence, or absence, of common features or characteristics of trade i.e. badges of trade. Some of these badges tend to be more pertinent to individuals who may be trading rather than companies, but are included here for completeness. These factors were codified by a Royal Commission in 1955, and since then other elements have also become important, which are included in the table below.

It is not necessary to show that all the badges are present for an activity to be a trade.

**Comment** **Intention** to trade is usually not admitted by a person who disputes the taxation treatment of a transaction. It is important to differentiate between the intention to trade and the intention to seek a profit from a transaction (¶450). Intention can be ignored where the facts and circumstances behind a transaction support one contention far more than the other, whether this be to the advantage or disadvantage of the taxpayer. Indeed, HMRC prefer to decide a case on its merits, based on the badges of trade, without having to rely on the stated or inferred intention of the taxpayer. The only time when intention is of paramount importance is when the facts are inconclusive, or where a transaction is undertaken with a dual motive (e.g. land acquired to accommodate an existing trade but also with a view to development and resale).

420

BIM 2001

## Summary

Badge	Detail	¶¶
Nature of the asset	Is it of a type normally sold for profit?	¶424
Period of ownership	Shorter period usually indicates trading	¶432
Frequency and number of transactions	Repeated transactions support the existence of a trade	¶434
Changes made to the asset	Repaired or improved to maximise sale proceeds?	¶440
How was the sale carried out	Sold in a way typical of trading?	¶442

422

Badge	Detail	¶¶
Profit seeking motive	An intention to make a profit supports trading, but by itself is not conclusive	¶450
Method of acquisition	Acquired as a gift or inheritance?	¶458
Source of finance	Was borrowing necessary, or were other assets sold	¶460
Existence of similar trading transactions	Does the scope of existing trade extend to new transactions	¶462
Mutual trading	Trading with company members	¶464

## 1. Nature of the asset

The nature of the asset can be of great importance when considering whether a trade exists, as some assets are clearly only bought to sell on (e.g. toilet rolls). On the other hand, others are unlikely to be the subject to a trading adventure because there is a **presumption** (although not exclusively so) that they are bought either:

- for investment and perhaps exploited for income (e.g. shares);
- for personal enjoyment e.g. a painting, where any profit made on eventual sale is a welcome by-product of ownership rather than an end in itself; or
- as capital assets for an existing trade e.g. a printing press.

424  
BIM 20245

BIM 20265

s 21 ITTOIA 2005

### MEMO POINTS

1. The **number of items acquired** may indicate a trading situation. HMRC caution that other badges of trade should be present irrespective of the number of items.

2. **Land** can be held for investment or as trading stock, and therefore the nature of land is of no help in deciding whether a trade exists.

### EXAMPLE

1. A man with various business interests (including lending money and owning a cinema company) was offered the chance to acquire over 1 million toilet rolls in a single purchase while in Berlin. Back in the UK, he sold the whole lot in a single sale transaction.

It was held that the sale amounted to an adventure in the nature of trade. *Rutledge v CIR* [1929]

2. A woodsman, with no prior experience of the whisky trade, bought whisky in bond for £407. A couple of years later, he sold it for £1,131. In the meantime, the consignment was never delivered to him, and he did not advertise in order to make the sale.

It was held that the transaction was an adventure in the nature of trade. *CIR v Fraser* [1942]

## Income producing

If an asset is **exploited for** income e.g. rent or dividends, then this would initially indicate an investment situation.

If, however, **expenses** are incurred in relation to the asset e.g. interest on borrowings, and as a result no profit is made (or indeed a loss is sustained) while the asset is owned, this would nullify the income producing advantage (other than to reduce the cost of holding the asset). In this case, any positive financial benefit could only be crystallised once the asset was sold. Whilst this is not necessarily indicative of trading, it does mean that the income derived from the asset cannot be a factor which implies an investment intention.

### EXAMPLE

A solicitor purchased a farm and surrounding land, with the majority of the cost funded by a mortgage. The rental income only covered half of the mortgage interest.

The solicitor submitted plans for development, although he did not undertake further work himself, nor did he advertise any plots for sale. As a result of third parties approaching him to make a deal, he managed to sell over 20 building plots over a period of 5 years.

It was held that the solicitor was carrying on a trade rather than holding a long term investment. *Cooke v Haddock* [1960]

426  
BIM 20250

## Value

Assets are often held until they **appreciate** in value, perhaps as an alternative to income yield. However, if an asset is sold within a short time scale, has no **aesthetic** value, and produces no income, this may indicate trading.

**EXAMPLE** An actor was worried about the possible devaluation of the pound. So he decided to buy silver bullion which was linked to the US\$, and had enjoyed a steady value over the past 3 years. Due to market fluctuations, the actor made a large profit on various bullion transactions, although he stated that this was not his intention. Some of the transactions necessitated heavy borrowing, with high interest charges, which could only be repaid by selling the bullion. It was held that the transactions were an adventure in the nature of trade because the bullion itself served no use, did not produce any income, and the intention had been to hedge against devaluation. *Wisdom v Chamberlain* [1968]

**428**

BIM 20250

## Financial assets

Transactions in financial assets, such as shares, options and bonds do not of themselves indicate trading, although of course if this activity is undertaken within a financial trade e.g. banking, then there is no doubt as to how the transactions should be treated.

Such assets are normally held for investment purposes, either for income production or capital growth.

**Selling** these assets after a short period of ownership might be classed as speculation akin to gambling, which does not amount to trading. If there is a cohesive strategy which determines when to buy and sell, this could be to satisfy either a trading or investment objective. Hence other factors should be reviewed in order to settle the question.

HMRC treat **derivatives** and other transactions, which mirror the risks and rewards of share ownership, no differently from the actual assets themselves.

**EXAMPLE** A fruit and vegetable importing company started making stock market deals after suffering a downturn, employing new people as a consequence and maintaining proper accounts. Stocks were held for a period of less than 1 year. The directors were advised that this activity was within the scope of the company's Memorandum of Association. Unfortunately the deals resulted in losses. The issue was whether this amounted to a trade of dealing in shares or mere speculation. It was held that a trade was being carried on, as the company obviously intended to resell the stocks rather than hold them for the longer term. *Lewis Emmanuel v White* [1965]

**430**

BIM 20252

## CHAPTER 8

**Sundry items including anti-avoidance**

OUTLINE		99
<b>SECTION 1 Miscellaneous income</b> .....		
	2220	
A	General principles .....	2225
	Recognition .....	2225
	Losses .....	2227
	Summary of main provisions .....	2230
B	Tax repaid in error .....	2236
C	Commissions .....	2240
<b>SECTION 2 Estate income</b> .....		
	2275	
A	General principles .....	2277
	Income in the estate .....	2277
	Grossing up .....	2280
	Payments from the estate .....	2282
B	UK estates .....	2284
C	Foreign estates .....	2290
<b>SECTION 3 Anti-avoidance</b> .....		
	2320	
A	Transactions in securities .....	2326
1	General principles .....	2328
2	Circumstances .....	2332
	Summary .....	2332
3	HMRC counteraction .....	2340
B	Life policies .....	2346
1	Scope .....	2348
2	Occasions of tax charge .....	2350
3	Tax treated as already paid .....	2352
<b>C Offshore funds</b> .....		
	2360	
1	Scope .....	2362
2	Types of fund .....	2366
3	Reporting funds .....	2368
4	Non-reporting funds .....	2374
5	Change of status .....	2386
6	Transitional rules .....	2388
<b>D Structured finance arrangements</b> .....		
	2396	
1	General principles .....	2396
2	Simple structures .....	2402
3	Complex structures .....	2408
<b>SECTION 4 Charitable giving</b> .....		
	2440	
A	Gift aid .....	2445
1	Exceptions .....	2447
2	Benefits received by the company .....	2454
3	Computation .....	2461
4	Recipients .....	2466
B	Transfers of assets .....	2472
	Qualifying investments .....	2474
	Qualifying recipients .....	2478
	Nature of the disposal .....	2480
	Timing .....	2482
	Deduction .....	2484
	Administration .....	2490

- 2210** In addition to the general rules for the adjustment of profits for certain categories of income, there are specific provisions in relation to:
- items falling to be treated as miscellaneous income;
  - estate income;
  - anti-avoidance rules such as transactions in securities; and
  - charitable donations.

## SECTION 1

## Miscellaneous income

Although most income received falls to be classified within one of the main categories (e.g. trading, interest, property business), a number of types of income are assessable to tax in the catch-all known as miscellaneous income.

Before taxing an item within this category, the company should ensure that:

- the item has the qualities of income rather than capital (¶1970);
- it is taxable i.e. it is not gratuitous and therefore outside the scope of corporation tax e.g. winnings from gambling, money derived from a hobby or income received as a gift; and
- there really is nowhere else for the item to appear in the tax computation.

**2220**  
s 979 CTA 2009

### A. General principles

#### Recognition

The general rule is that miscellaneous income is assessed on the profits received during an accounting period.

Where **accounts are prepared for a period in excess of 12 months**, the accounts figures should be apportioned on a daily basis to arrive at the income for each accounting period. The amount included in the tax computation is the gross amount, regardless of whether **income tax** has been deducted at source. Relief will be available for any income tax suffered on miscellaneous income in accordance with the normal rules (¶5166).

Special rules apply to **patent income** (¶3706).

**2225**

#### Losses

Relief for losses incurred on transactions which would be assessable under the term miscellaneous income (if profitable) can be obtained by setting the loss against other miscellaneous income for the **same period**, or, if this is not possible, by carrying forward the loss and setting it against **future profits** of any miscellaneous income.

**2227**  
s 91 CTA 2010

#### Summary of main provisions

Topic	¶¶
Tax repaid in error	¶2236
Commissions	¶2240
Anti-avoidance	¶2320+

**2230**

#### MEMO POINTS

1. For **post cessation receipts**, see ¶6927.

2. Other than for charitable recipients, a **discretionary payment** made by trustees from a UK resident trust is ignored for corporation tax purposes, so it will not be included in income, and the tax deducted at source will not be available for set off or repayment. For payments from estates, see ¶2275.

3. Income arising from the holding of an office by the company is liable to corporation tax. The taxable amount is calculated with regard to the income tax rules which apply for the tax year in which the accounting period ends (see *Tax Memo* for details of employment income).

4. Where **foreign dividend coupons** (i.e. relating to shares outside the UK) are sold, the proceeds are taxed as miscellaneous income.

5. **Annual payments**, which are not charged to corporation tax under any other rule (although not because of an exemption), are liable to corporation tax as miscellaneous income. For this

**2232**  
s 610 CTA 2010

s 969 CTA 2009

s 974 CTA 2009

s 976 CTA 2009

purpose, annual payments include items such as annuities, and are characterised by a legal obligation to pay, and by being treated as income in the hands of the recipient. If a payment forms part of the recipient's trading receipts, it is not an annual payment. The word annual in this respect does not imply a payment once a year, but denotes a quality of recurrence; the obligation must cover a period of more than 1 year to be considered an annual payment.

---

## B. Tax repaid in error

**2236**Sch 18 paras 52, 53  
FA 1998

Where there has been an **over repayment** of tax, an assessment can be made to recover tax which HMRC discover has been repaid to the company in error.

Such an assessment treats the amount repaid as miscellaneous income, and carries interest from the date on which it was repaid until such time as the company pays the tax.

For further details, see ¶6088.

---

## C. Commissions

**2240**

SP 4/97

Commission income can be received following the introduction of a customer to a supplier of goods or services. The tax treatment depends upon whether the company has a trade.

### Trading companies

**2242**

Where the company who makes the introduction is trading, and regularly receives such commission income, this will be taxed as trading income.

Even where the company arranges for the **customer to receive the commission direct** (by a reduction in insurance premiums for example), it will remain taxable trading income on the company so long as it has an enforceable legal right to the commission which is forgone in favour of the customer. However, where the company does not receive the commission, and has never had any entitlement to it, there will be no taxable receipt.

### Non-trading companies

**2244**

Where the company making the introduction is not trading, the commission will be taxable as miscellaneous income if it arises under an enforceable contract.

### Commission passed on

**2246**

Where the commission is passed on to the customer, a **deduction** will be available if the customer required the commission to be passed on to him as a condition of entering into the transaction. However, where an ordinary retail customer receives a sum for purchasing goods or services, this will not be taxable on him.

---

## SECTION 2

### Estate income

**2275**

On the death of an individual, the property in his estate does not pass directly to the legatees or under the rules of intestacy. Instead, the property vests in the personal representatives who are responsible for collecting the property, settling any outstanding liabilities or obligations, and then distributing the residue.

An estate is therefore akin to a company, as beneficiaries of the estate cannot access their property or income until it is distributed by the personal representatives. Such distributions can occur both during the administration period, and once the administration of the estate is complete.

## A. General principles

### Income in the estate

The income from the estate will retain its identity in the hands of the beneficiary, and will be taxed at the rate applicable for that source. **2277**

A company beneficiary is entitled to request a **statement** from the personal representatives, detailing the income arising to the company from the estate in a particular accounting period, including any tax treated as borne on that income. s 967 CTA 2009

### Grossing up

Each source of income is grossed up at the basic **rate** or dividend ordinary rate as appropriate. Payments are deemed to be made first out of income taxable at the basic rate, and then from dividend ordinary rate income. **2280**

### Payments from the estate

The treatment of sums paid to beneficiaries during the administration of an estate will depend on the beneficiary's interest in the estate, and also whether the estate is a UK one or foreign. **2282**

**MEMO POINTS** For this purpose, a **foreign estate** (¶2290) is one where not all of the income is subject to UK tax, or where the personal representatives are not directly assessable e.g. they are all non-resident. ss 934 – 936 CTA 2009

Type of interest	Description	¶¶
Absolute	Once the administration of the estate is complete, the beneficiary will be entitled to both the income and capital in his own right	¶2284
Limited	Entitles the beneficiary to a right to income once the administration of the estate is complete (e.g. a life tenant or immediate post death interest)	¶2286
Discretionary	The beneficiary is only entitled to any income of the residue where a discretion is exercised in the company's favour	¶2288

## B. UK estates

### Absolute interest

Payments made to a beneficiary with an absolute interest will be treated as income for the accounting period in which the payment is made. **2284**

The amount treated as **income** will, however, be **limited** to the extent of the beneficiary's entitlement to the residuary income in each accounting period, up to and including the year of payment. Any excess over the entitlement to residuary income will be treated as a payment of capital. ss 937, 938 CTA 2009

Where there are **excess estate expenses** compared to the residuary income, these are carried forward and deducted against the income of the following period.

**MEMO POINTS**

1. **Residuary income** for these purposes is defined as the aggregate of estate income excluding specific dispositions and contingent distributions, less interest (other than interest on late inheritance tax) which is charged on the residue.

2. When the **administration of the estate ends**, any unrelieved expenses will be set against any remaining income which has not yet been paid out.

## Limited interest

**2286**

ss 939, 944  
CTA 2009

Income arises to a beneficiary with a limited interest in the accounting period in which payment is made.

Amounts that remain payable to the beneficiary, **once the administration has been completed**, are treated as received in the year that the completion occurred. The exception to this rule is where the limited interest ceased before the completion of the administration, when the income is treated as received by the beneficiary in the accounting period of cessation.

## Discretionary interest

**2288**

s 940 CTA 2009

Similarly, income arises to a beneficiary with a discretionary interest in the accounting period in which payment is made by the personal representatives.

# C. Foreign estates

**2290**

If a company receives a payment from a foreign estate which has suffered UK income tax on part of its aggregate income, the corporation tax payable may be reduced. The reduction depends on the type of interest held by the company.

## Absolute interest

**2292**

s 960 CTA 2009

Where the beneficiary has either a limited or discretionary interest and submits an appropriate claim, the tax chargeable will be reduced by the following **formula**:

$$T \times \frac{A}{B}$$

where:

- T is the corporation tax charge;
- A is the amount of the estate's income which has borne UK income tax;
- B is the aggregate income of the estate for the relevant tax year.

For this purpose, the **relevant tax year** is the tax year which would apply if the company was within the charge to income tax.

## Limited and discretionary interests

**2294**

s 961 CTA 2009

Where the beneficiary has either a limited or discretionary interest and submits an appropriate claim, the tax chargeable will be reduced by the following **formula**:

$$T \times \frac{A - C}{B - C}$$

where:

- T is the corporation tax charge;
- A is the amount of the estate's income which has borne UK income tax;
- B is the aggregate income of the estate for the relevant tax year (¶2292); and
- C is the amount of income tax already borne by the aggregate income for the relevant tax year.

## CHAPTER 4

**Special situations**

OUTLINE		¶¶
<b>SECTION 1 Substantial shareholding exemption</b> .....	7505	
Size of the shareholding .....	7507	
Period of ownership .....	7510	
Qualifying activity .....	7512	
<b>SECTION 2 Intangible fixed assets</b> .....	7520	
1 Definition of group .....	7522	
2 Intra-group transfers .....	7526	
3 Leaving a group .....	7532	
Scope .....	7534	
Exclusions .....	7536	
Calculation .....	7542	
Rollover .....	7544	
Reallocation .....	7546	
Unpaid degrouping charge .....	7548	
4 Reinvestment relief .....	7550	
Summary .....	7552	
<b>SECTION 3 Loan relationships</b> .....	7570	
A Intra-group transfers .....	7572	
B Leaving the group .....	7578	
C Group mismatch schemes .....	7584	
<b>SECTION 4 Derivatives</b> .....	7600	
A Intra-group transfers .....	7602	
B Leaving the group .....	7606	
<b>SECTION 5 Shadow ACT</b> .....	7615	
A Intra-group distributions .....	7617	
B Surplus shadow ACT .....	7622	
<b>SECTION 6 Administration</b> .....	7630	
A Group payment arrangements .....	7632	
Eligibility .....	7634	
Application .....	7636	
Effect .....	7638	
Duration .....	7640	
Termination .....	7642	
B Surrender of tax refund between group members .....	7644	
Conditions .....	7646	
Effect .....	7648	
Payment for surrender .....	7652	
C Recovery of tax payable by non-resident group member .....	7654	

In addition to the rules on group loss relief, and the capital gains regime for groups of companies, there are a number of other topic areas where there are specific rules for groups, as shown in the following table:

**7500**

Topic	¶¶
Substantial shareholding exemption	¶7505
Intangible fixed assets	¶7520
Loan relationships	¶7570
Derivatives	¶7600
Shadow ACT	¶7615
Administration	¶7630

## SECTION 1

## Substantial shareholding exemption

## 7505

An exemption applies to the disposal by a company of substantial shareholdings (¶4254), known as the SSE. This means that no chargeable gain or allowable loss arises. As the exemption is automatic, no claim is required.

There are particular rules which apply when a group is using the SSE. For this purpose, group means a 75% CG group (¶7085), except that subsidiaries need only be 51% owned.

For the interaction of the SSE and degrouping charge when a company leaves a group, see ¶7371.

**Comment** These provisions allow a group to transfer shares to a newly incorporated company, and then dispose of the shares in the new company, without losing the benefit of SSE.

## Size of the shareholding

## 7507

Sch 7AC para 9  
TCGA 1992

A substantial shareholding is **defined** as a holding of not less than 10% of the ordinary share capital of a company, which carries an **entitlement** to not less than 10% of both the:

- profits available for distribution to its equity holders; and
- assets on a winding up available to its equity holders.

In determining whether a company has a substantial shareholding in a target company, any shares or interests in shares **held by other 51% group members** (¶7110) in the target company are aggregated. For this purpose, companies may be located anywhere in the world (assuming they have the equivalent to ordinary share capital e.g. some Limited Liability Companies in the USA have no share capital, so they cannot be part of such a group).

The investing company is deemed to have the same entitlement to any rights enjoyed, by virtue of the shares, as the group member to which the shares actually belong.

## Period of ownership

## 7510

Sch 7AC para 10  
TCGA 1992

The investing company must have held a substantial shareholding (¶4258) in the target company for a continuous 12 month period, beginning not more than 2 years prior to the disposal.

Where shares held by the company were **previously transferred** to it **at no gain/no loss**, the transferor's period of ownership is included.

## Qualifying activity

## 7512

Sch 7AC para 18(4)  
TCGA 1992

The **investing company** must be carrying on trading activities throughout the 12 month period (and immediately after the date of disposal), and its activities cannot, to a substantial extent (¶4266), include non-trading activities.

In determining whether this condition has been met, the activities of a **fellow group company** can be taken into account.

For **joint ventures**, see ¶4264+.

## SECTION 2

## Intangible fixed assets

## 7520

There are particular rules in respect of intangible fixed assets which affect groups.

## MEMO POINTS

1. For details of the **intangibles regime** generally, see ¶3540.
2. For the **group relief** of non-trading debits on intangible assets, see ¶7147.

## 1. Definition of group

A group, for the purposes of these rules, means a principal company and its 75% subsidiaries. A subsidiary must also be an effective 51% subsidiary of the principal company.

A company can only be a member of one group at any one time.

**MEMO POINTS** 1. An **effective 51% subsidiary** is one in which the principal company holds the rights to more than 50% of:

- profits available to equity holders on a distribution; and
- assets available to equity holders on a winding up.

For further details, see ¶7094.

**7522**  
ss 765, 766, 771,  
772 CTA 2009

## Determining the relevant group

A 75% **subsidiary is prohibited from being a principal company**, unless it cannot be in the same capital gains group as its parent because it is not an effective 51% subsidiary of the parent's principal company.

For details of how to ascertain which group a particular subsidiary is in, see ¶7100.

**7524**  
s 768 CTA 2009

## 2. Intra-group transfers

Even though group members are related parties, the transfer of intangible fixed assets from one group company to another is tax neutral (which effectively is the same as taking place on a no gain/no loss basis for capital gains purposes), provided that the assets are within the scope of the intangibles regime (¶3540).

**MEMO POINTS** 1. If a group member **subsequently leaves the group**, while still holding the intangible asset, there may be a degrouping charge (¶7532).

2. Note that there must actually be an asset **transfer** for these rules to apply. So the grant of a license to exploit a patent, for example, is not a transfer.

3. Assets **not within the scope of the intangibles regime**, primarily due to the date of acquisition, will probably qualify for a no gain/no loss transfer under the capital gains code (¶7304).

4. **Non-resident companies** may be members of a group, but the asset will not be within the scope of the intangibles regime unless it is held for the purposes of a trade carried on in the UK through a UK permanent establishment (¶9546) by the non-resident group member. Where a tax neutral transfer is not available, the transfer pricing rules (¶7680) should be considered.

**7526**  
ss 775, 776  
CTA 2009

CIRD 40250

## Exclusions

The tax neutral treatment of an intra-group transfer of intangible fixed assets does not apply where:

- the transferor or the transferee is a friendly society; or
- the transferee is a dual resident investing company (¶9460).

**7528**  
s 775(4)(a), (b)  
CTA 2009

## Consequences

The **transfer is treated** as though it involves neither a disposal nor an acquisition.

Additionally, the **transferee** is treated as the owner of the asset throughout, inheriting the transferor's tax history, including the tax cost (which is basically the cost recognised for accounting purposes less any reinvestment relief (¶3610)) and all debits and credits already accounted for. So the transferee stands in the shoes of the transferor.

**7530**

## 3. Leaving a group

A degrouping charge will arise when a company leaves a group while still holding an intangible fixed asset, which had been transferred to it (from another group member) within the previous 6 years.

**Comment** The aim of the degrouping charge is to ensure that the increase in value of an asset during its period of ownership is crystallised even if the asset leaves the group within a company.

**7532**  
s 780 CTA 2009;  
CIRD 40510

## Scope

**7534**  
s 788(3) CTA 2009

This rule also operates where:

- an **associated company** of the departing company holds the asset and leaves the group with the departing company i.e. it is not possible to avoid the degrouping charge merely by transferring the asset to another group member who also leaves the group. For this purpose, a company is associated with another when both are in a 75% group relationship; or
- an asset **derives** its value from another asset which was transferred.

s 788(2) CTA 2009

The charge **accrues to** the departing company, unless there is an election to reallocate it to another group member (¶7546) or roll it over (¶7544).

The charge itself may be a debit or a credit.

**Comment** Unlike the capital gains rules for tangible fixed assets, no degrouping charge will arise when an asset leaves the group against which a credit has been rolled over.

## Exclusions

**7536**  
ss 782 – 789  
CTA 2009

A degrouping charge does **not arise** in the following situations:

Situation	Detail
Company ungrouped	As a result of an exempt distribution (¶8318) Where there is a chargeable payment (¶8323) within 5 years, the degrouping charge will be reinstated Any necessary adjustments can be made within 3 years of the date of the chargeable payment
	A company ceases to be in a group because another company (which HMRC considers must be its only subsidiary) ceases to exist i.e. on its actual dissolution This also applies where all of a company's subsidiaries cease to exist simultaneously
Mergers (¶8430)	A commercial merger of a UK resident company with a company resident in another member state of the EU, including a Societas Europea
	A demerger taking place (¶8305)
Two companies leave the group together	See ¶7538+

**7538**  
s 783 CTA 2009

**Two associated companies leaving together** No degrouping charge arises where the transferor and transferee company **form a subgroup**, and leave the original group together. This exception only applies where the companies also formed a subgroup at the time when the asset was originally transferred. Where a company leaves a group on or after 19 July 2011 (or 1 April 2011, where an appropriate election (¶7352) is made), no degrouping charge will arise where the transferor and transferee are part of the same subgroup at all times from when the asset is transferred until immediately after they leave the original group.

However, if the **transferee company subsequently leaves** the second group within 6 years of the original intra-group transfer, and there is a relevant connection between the first group and the second group, a degrouping charge will be imposed at that time. For this purpose, the asset is deemed to have been transferred when both companies were members of the second group, so creating a degrouping adjustment at the time that the company leaves the second group.

### MEMO POINTS

1. Being **part of the same subgroup** means that either:

- both companies are 75% subsidiaries and 51% effective subsidiaries of another company; or
- one is such a subsidiary of the other.

2. A **relevant connection** exists where, when the transferee leaves the second group, the parent company of the second group is under the control of:

- the principal company of the first group;
- any person who controlled the first group, or has done so since the transferee ceased to be a member;
- any persons who controlled the parent company of the parent company of the first group, where that company has ceased to exist; or
- any person who controls any person above which is a company.

s 784 CTA 2009

**Parent company joins another group** Where two groups join together, some companies in the target group **may not be effective 51% subsidiaries** of the new principal company (¶7094).

No degrouping charge applies in this situation, as long as the company is a 75% subsidiary and also an effective 51% subsidiary of at least one member of the new group. Where this condition is broken within 6 years of the transfer of the asset, and the same company, or another group member, holds the asset, a degrouping charge will arise.

## Calculation

The degrouping charge is calculated by **deeming the asset** to have been disposed of and reacquired for its market value **immediately after** the intra-group transfer took place.

The **tax written down value** going forward is therefore market value.

The charge is treated as **arising** immediately before the company left the group.

So the amount of the charge will be based on circumstances existing when the asset was transferred intra-group, but will be chargeable to tax in the accounting period when the company leaves the group.

The **charge to tax** depends on the use made of the intangible asset by the transferee as follows:

- trading purpose or property business (¶3632); or
- non-trading purpose (¶3634).

If the transferee has ceased to trade, the asset will be treated as a non-trading item.

In the **accounting period of departure**, the degrouping charge must be aggregated with the adjustments required to the credits and debits occurring in the intervening accounting periods i.e. between the date of the intra-group transfer and the accounting period in which the company leaves the group (as the tax written down value on the intra-group transfer is now deemed to be market value).

**7540**  
s 785 CTA 2009

**7542**  
s 857 CTA 2009

s 871 CTA 2009

**7543**

CIRD 40610

### EXAMPLE

1. Asset X has a 10 year life and is acquired by A Ltd for £10,000 in Year 4. Asset X is amortised at a rate of £1,000 per year. By the end of Year 6, the total amortisation is £3,000. (3 × 1,000)

At the beginning of Year 7, Asset X is transferred to B Ltd, a group company, for its book value of £7,000. Its market value at this date is £9,000. In Year 7 and Year 8, B Ltd amortises the asset at £1,000 p.a.

B Ltd leaves A Ltd's group at the end of Year 8.

B Ltd is deemed to have sold and reacquired the asset for £9,000 at the time of the asset transfer, leading to a credit of £2,000. (9,000 – 7,000)

B Ltd's amortisation deduction for Year 7 is adjusted to reflect an acquisition cost of £9,000 rather

than £7,000, so the revised amortisation charge is £1,286. ( $\frac{9,000}{7,000} \times 1,000$ )

The increase in amortisation is therefore £286. (1,286 – 1,000)

This is netted off against the degrouping charge, and the amount of £1,714 is brought into account in Year 8. (2,000 – 286)

The amortisation debit for Year 8 is £1,286.

The tax written down value when B leaves the group is therefore £6,428.

These adjustments are summarised below:

	£
<b>Year 7</b>	
Tax written down value b/fwd	7,000
Degrouping credit	<u>2,000</u>
	9,000
Amortisation	<u>(1,286)</u>
<b>Year 8</b>	
Tax written down value b/fwd	7,714
Amortisation	<u>(1,286)</u>
Tax written down value c/fwd	6,428

2. At the beginning of Year 1, C Ltd transfers its business as a going concern to D Ltd for its book value. As the market value of the business exceeds the book value by £20,000, this is the amount of internally generated goodwill. D Ltd leaves C Ltd's group at the end of Year 3. D Ltd is deemed to have sold and reacquired the asset for £20,000, and this gives rise to a taxable credit of £20,000 (as C Ltd had no acquisition cost). Amortisation charges will depend on the estimated useful life of the goodwill, and if this is assumed to be 10 years, amortisation of £2,000 p.a. will apply in Years 1 and 2. This is netted off against the degrouping charge, and the amount of £16,000 is brought into account in Year 3. (20,000 – 2,000 – 2,000) An amortisation debit of £2,000 is also given in Year 3, so that the TWDV of the asset when D Ltd leaves the group is £14,000. (16,000 – 2,000)

## Rollover

**7544**  
s 791 CTA 2009

Where a degrouping charge arises, it is possible to roll it over into replacement expenditure (¶17550).

## Reallocation

**7546**  
ss 792, 793  
CTA 2009

No reallocation is possible if the degrouping charge gives rise to a deductible **debit**.

Any **further adjustments** which result from the degrouping charge, such as changes to amortisation between the date of the asset transfer and the date of departure from the group, stay with the departing company, and cannot be reallocated.

It is possible to reallocate a degrouping charge which is a **credit** where the companies are:

- in the same group immediately before the transferee left the group; and
- both within the charge to UK corporation tax i.e. resident in the UK or trading through a UK permanent establishment (¶19546).

A joint **election** must be made within 2 years of the end of the accounting period in which the transferee leaves the group.

The degrouping charge is treated as a non-trading credit of the recipient.

s 799 CTA 2009

- MEMO POINTS**
1. Any **payment between the companies for the transfer** is ignored for tax purposes, so long as it does not exceed the amount reallocated, and is made under a formal agreement.
  2. In the event of the degrouping charge arising as a result of the **transferee leaving a second group** (¶17538), the company, to which the charge is reallocated, must be in that group immediately before the transferee leaves.

## Unpaid degrouping charge

**7548**  
ss 795, 797  
CTA 2009

Where a degrouping charge remains unpaid 6 months after the due date for payment, HMRC may **recover** the amount due **from**:

- the principal member of the group (at the date when the gain accrued); or
- any other company which had owned the asset, and was a group member at any time up to 12 months before the company left the group.

HMRC will serve a notice **demanding payment** within 3 years from the date when the amount of the degrouping charge is determined. A 30 day payment period is given by the notice, and the tax due is then treated as a liability of that person. There is a right of appeal against the notice.

The person paying the liability can of course try and recover the amount from the defaulting company.

CIRD 40710

- MEMO POINTS**
1. The **notice** must state the amount of:
    - the tax referable to the degrouping charge; and
    - corporation tax which remains unpaid for the relevant accounting period, and the date when it became payable.

The **amount due** is the lesser of:

- the unpaid corporation tax assessed on the company for the accounting period in which the gain accrued; and
- the tax referable to the amount of degrouping charge.

s 87A TMA 1970

2. **Interest** will be due on the amount shown on the notice if payment is not made within the 30 day period. The amount is treated as overdue corporation tax for this purpose.

3. If the company is a **non-UK resident**, recovery can also be made from a controlling director i.e. any person who is, or was within the period of 12 months up to the departure date, a controlling director of:
  - that company, or
  - of another company which, within that 12 month period, had control of that company.
4. **Controlling director** is defined as a director who controls (17836) the company.