technical

corporation tax losses – part 2

relevant to new ACCA Qualification Paper F6 (IRL)

relief

This is the second of two articles on company losses. The first article looked at the ways in which a company can use its trade losses. This article covers the relief available to a company for Case V and capital losses. It also outlines the tax consequences if a company is late in submitting its corporation tax return (CT 1).

CASE V LOSSES – SECTION 399

If a company makes a Case V loss (when expenses exceed rental income), it can carry the loss back to a previous period of corresponding length, to reduce Case V income only. The carry-back section is a choice open to the company. The time limit for claiming this relief is two years from the end of the accounting period in which the loss arose. If the company does not carry the Case V loss back to a previous period, or if there is still some loss remaining, it must carry the loss forward and reduce the next available Case V income.

EXCESS CASE V CAPITAL ALLOWANCES – SECTION 308

Two categories of buildings qualify for capital allowances – industrial buildings and buildings situated in tax designated areas. A company which owns an industrial building and lets it out, is entitled to capital allowances against its rental income. If the capital allowances exceed rental income, a company is entitled to relief for the excess Case V capital allowances under Section 308.

The relief is as follows:

1. In the current period (the period in which the excess arises), the company can reduce total profits before charges by the excess Case V capital allowances. Section 308 reduces all profits, reducing those profits taxed at the highest rate first.
2. Any excess still available can be carried back to a previous period of corresponding length, again to reduce total profits before charges.
3. Any balance still remaining is carried forward to reduce Case V income in a future period.

The claim in the current and previous period is a choice open to the company. The time limit for the claim is two years from the end of the accounting period in which the excess arose.

EXAMPLE 1

	Year ended 31.12.05	Year ended 31.12.06	Year ended 31.12.07
	€	€	€
Case I	30,000	35,000	48,500
Case V	10,000	10,000	10,000
Case V capital allowances	2,000	70,000	5,000
Case III	5,000	5,000	5,000
Gain – adjusted	-	18,000	-

Requirement

Calculate the company's corporation tax for all periods, making maximum use of all relief.

Solution

Section 308 calculation

Year ended 31.12.06

	€
Case V	10,000
Less: capital allowances	70,000
Case V	Nil

Excess Case V capital allowances €60,000

Step 1
The excess is first used to reduce this period's total profits.

	€
Case I	35,000
Case V	Nil
Case III	5,000
Income	40,000
Gain	18,000
Profits	58,000
Section 308	(58,000)
	Nil

Section 308 remaining
€60,000 - €58,000 = €2,000
This is carried back to the previous period of corresponding length to reduce total profits.

Step 2
Year ended 31.12.05

	€	€
Case I		30,000
Case V	10,000	
Less: capital allowances	(2,000)	8,000
Case III		5,000
Income		43,000
Section 308		(2,000)
		41,000

Corporation tax
Section 308 reduces all profits, reducing profits taxed at the highest rate first. This would be the Case V and Case III income, which is taxed at 25%.

	€
Case V	8,000
Case III	5,000
	13,000
Less: Section 308	2,000
	11,000

Corporation tax

€30,000 @ 12.5% =	€3,750
€11,000 @ 25% =	€2,750
	€6,500

Section 308 remaining is nil.

Time limit for claim: 31.12.08

Year ended 31.12.07

	€	€
Case I		48,500
Case V	10,000	
Less: capital allowances	(5,000)	5,000
Case III		5,000
Income		58,500

Corporation tax

€48,500 @ 12.5% =	€6,063
€10,000 @ 25% =	€2,500
	€8,563

CAPITAL LOSSES

If a company sells an asset and makes a loss (as opposed to a gain), what relief is available to the company for that loss? Capital losses can only reduce capital gains in the current period. If there is any loss still available, it is carried forward to reduce capital gains in a future accounting period.

EXAMPLE 2

	12 months 31.12.05	9 months 30.09.06	12 months 30.09.07
	€	€	€
Case I	50,000	(40,000)	10,000
Case V	15,000	16,000	(1,000)
Case V capital allowances	10,000	10,000	10,000
Case III	4,000	4,000	4,000
Gains – adjusted	5,000	(3,000)	6,000

Requirement
Calculate the company's corporation tax for each period, making maximum use of all losses.

Solution
As this example has more than one type of loss it is best to use a fixed structure when answering the question. A good way to start is by deciding in advance what relief to give for the other losses besides the trade loss.

a **Capital loss: accounting period – nine months 30.09.06**
This loss will be carried forward to reduce gains in the accounting period 12 months 30.09.07.

b **Case V loss: accounting period – 12 months 30.09.07**
This loss will be carried back to a previous period of corresponding length to reduce Case V income. Because the loss arose in a 12-month period it can be carried back 12 months. The previous period is only nine months in length, therefore the loss can reduce the rental income of this period.

c Excess Case V capital allowances: accounting period – 12 months 30.09.07

The Case V income for this period is nil because the company has a loss. Therefore, the company will have excess Case V capital allowances of €10,000. The company will use this excess to reduce total profits of this accounting period.

After deciding the relief for the other losses, trade losses can be utilised as follows:

1 Use the trade loss to reduce trading income liable at the standard rate in the previous period of corresponding length.
2 Use any excess trading loss to reduce the company's corporation tax on a value basis in the current and previous period.

12 months 31.12.05

	€	€
Case I		50,000
Case V	15,000	
Less: capital allowances	(10,000)	5,000
Case III		4,000
Income		59,000
Gain		5,000
Profit		64,000
Less: trade loss Section 396A		
50,000 x 9/12		(37,500)
		26,500

Corporation tax

€12,500 @ 12.5% =	€1,563
€9,000 @ 25% =	€2,250
€5,000 @ 12.5% =	€625
	€4,438

Loss remaining €40,000 - €37,500 = €2,500

9 months 30.09.06

	€	€
Case I		Nil
Case V	16,000	
Less: capital allowances	(10,000)	
	6,000	
Less: loss	(1,000)	5,000
Case III		4,000
Income		9,000
Gain		Nil
Profit		9,000

Corporation tax

€9,000 @ 25% =	€2,250
Less: loss Section 396B	
€2,500 @ 12.5% =	(€313)
	€1,937

12 months 30.09.07

	€	€
Case I		10,000
Case V		Nil
Case III		4,000
Income		14,000
Gain	6,000	
Loss	(3,000)	3,000
Profits		17,000
Section 308		(10,000)
		7,000

Corporation tax

Section 308 reduces all profits, reducing profits taxed at the highest rate first. In this case, this is Case III income (as this is taxed at 25%), and is therefore reduced to nil. The balance of the company's profits, the trading income, and the gain are both taxed at 12.5%. For convenience, the gain is reduced to nil. The balance of Section 308 will reduce the trading income to €7,000.

€7,000 @ 12.5% = €875

Time limits

Trade loss:	30.09.08
Case V loss:	30.09.09
Excess Case V capital allowances:	30.09.09

Restrictions on loss relief

A company must file its tax return within eight months and 21 days after the end of its accounting period. If a company is late in filing its tax return, loss relief is restricted. The losses affected are as follows:

- Excess Case V capital allowances against total profits (Section 308).
- The carry back of Case V loss against Case V income of a previous period (Section 399).
- Set-off of trading losses against trading income liable at the standard rate (Section 396A).
- Set-off of trading losses on a value basis (Section 396B).

Where the return is less than two months late, the reliefs are restricted by 25%, subject to a maximum (in each case) of €31,740. Where the delay is two months or more, the reliefs are restricted by 50%, subject to a maximum of €158,715.

EXAMPLE 3

Year ended 31.12.07

Case I	€25,000
Case III	€8,000
Case V	€20,000
Case V capital allowances	€50,000

The company sent in its return for this period on 10 December 2008.

Requirement
Outline the consequences of the late return.

Solution
The first step is to find out whether the return is less or more than two months late. As the return should have been submitted on 21 September 2008, it is more than two months late. The consequences are twofold:

- The company will not be able to claim full relief for its excess Case V capital allowances. The relief will be restricted by 50%.
- The company will be liable to a surcharge of 10%.

Restriction of excess Case V capital allowances by 50%

Case V	€20,000
Case V capital allowances	€50,000
Case V	Nil
Excess Case V allowances	€30,000
Section 308 – 50% restriction	€15,000

Year ended 31.12.07

Case I	€25,000
Case III	€8,000
Case V	Nil
Income	€33,000
Section 308	€15,000
	€18,000

Corporation tax
Section 308 reduces those profits taxed at the highest rate first. The Case III income, which is taxed at 25%, is reduced to nil. The balance of the excess reduced Case I to €18,000.

€18,000 @ 12.5% = €2,250

The balance of Case V capital allowances, €15,000, is carried forward to reduce Case V income in a future accounting period.

Surcharge
€2,250 @ 10% = €225

EXAMPLE 4

Year ended 31.03.07

Case I	(€10,000)
Case III	€5,000
Gain – adjusted	€6,000

The company sent in its return for this period on 8 January 2008.

Requirement
Outline the consequences of the late return.

Solution
The first step is to find out if the return is less or more than two months late. As the return should have been submitted on 21 December 2007 it is less than two months late. The consequences are twofold – the company will not be able to claim full relief for its trading loss; the relief will be restricted by 25%, and the company will be liable to a surcharge of 5%.

Year ended 31.03.07

Case I	Nil
Case III	€5,000
Income	€5,000
Gain	€6,000
Profit	€11,000

Corporation tax

€5,000 @ 25% =	€1,250
€6,000 @ 12.5% =	€750
	€2,000
Less: trade loss Section 396B	
€10,000 x 75% x 12.5%	(€938)
	€1,062

The balance of the loss (€10,000 x 25% = €2,500) is carried forward to reduce profits of the same trade – Section 396(1).

Surcharge
€1,062 @ 5% = €53.10

CONCLUSION

You should now be able to:

- understand the treatment of Case I/II trading losses, Case V losses, excess Case V capital allowances, and capital losses
- calculate corporation tax computations while taking account of losses arising where there are periods of differing length and losses arising in respect of various sources of income
- claim loss relief in the correct order, calculate unused losses available for carry forward, and restrict the reliefs available when returns are filed late. ■

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