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Chapter 19

CHARGEABLE GAINS – COMPANIES

1 General

As seen in Chapter 15 companies pay corporation tax on their chargeable gains.

A chargeable gain arises on a chargeable disposal of a chargeable asset by a chargeable person as seen in Chapter 12 for individuals.

A UK resident company is chargeable on its worldwide gains and may dispose of a chargeable asset not only by sale but also on the loss or destruction of an asset.

As you will see in note 1.2 below the calculation of the gain contains one new component not applicable to individuals. Companies are given a deduction from the gain to remove the effect of inflation from when the asset was purchased to when it is sold, this deduction is known as indexation allowance.

All assets are chargeable assets unless they are specifically exempt.

1.1 Exempt assets

A more complete list of the main exempt assets may be found in Chapter 12 dealing with individuals but the main exempt assets that a company may dispose of would be motor vehicles, qualifying corporate bonds (corporate loan stock) and certain chattels.

The main chargeable assets that a company will dispose of will be shares, land and buildings and plant and machinery.

This and subsequent chapters will deal with these main assets.

1.2 Calculation of gains and losses for companies

	£
Disposal proceeds (or market value)	X
Less incidental costs of disposal	(X)
Net proceeds	X
Less allowable costs	(X)
Unindexed gain	X
Less indexation allowance	(X)
Chargeable gain	X

1.3 The indexation allowance

(a) For companies only, NOT individuals, the increase in value of an asset due to inflation is not taxable - this increase is removed from the gain by way of indexation allowance.

(b) Companies are entitled to an indexation allowance from the month of acquisition until the month of disposal of an asset and is computed by reference to the movement in the Retail Prices Index (RPI)

(c) It is calculated as:

$$\frac{\text{RPI for month of disposal} - \text{RPI for month of acquisition}}{\text{RPI for month of acquisition}} \times \text{cost of the asset}$$

(d) The increase in the RPI is expressed as a decimal and is rounded to three decimal places.

(e) The indexation allowance cannot increase or create a loss.

(f) If the RPI has fallen from the month of acquisition to the month of the disposal, the indexation allowance will be nil.

EXAMPLE 1

A company bought an asset on 6 June 1986 (RPI = 97.85) at a cost of £20,000.

Enhancement expenditure of £6,000 is incurred on 16 August 1990 (RPI = 128.1).

The asset is sold for £100,000 on 2 October 2014 (RPI assume = 257.7).

Incidental costs of sale are £1,000.

Calculate the chargeable gain arising on the disposal of the asset

2 Gains and losses

- (a) Capital gains are chargeable to corporation tax.
- (b) Capital losses only arise when net proceeds are less than allowable cost. Indexation allowance may not be used to either create or increase a loss.
- (c) If capital gains and losses arise in the same accounting period, they are netted off.
If the resultant figure is a gain, it is charged to corporation tax.
If the resultant figure is a loss, it is carried forward and set against future capital gains.
- (d) Capital losses brought forward may only be relieved against capital gains, not any other type of income.
- (e) The terms capital gains and chargeable gains are interchangeable.

3 Share matching rules for companies

Disposal of shares gives rise to a chargeable gain or allowable loss. It is difficult however to identify which shares are being sold, and therefore establish the cost of those shares sold where it is only some of the shareholding being sold and the shares had been acquired over a period of time at different costs. We need to identify the shares sold by using matching rules as laid down by HMRC which, as you may expect, are not exactly the same as the matching rules that we used when dealing with the same problem for individuals disposing of shares as we saw back in Chapter 13. Thus the shares sold are deemed disposed of in the following order::

- shares acquired on same day
- shares acquired in previous 9 days
- shares contained within the share pool which is made up of any shares acquired more than 9 days previous.

The share pool records the number and cost of shares for each acquisition and disposal as it did for individuals but also has to deal with the fact that companies are entitled to indexation allowance. Thus whenever shares are purchased or sold a reindexation of the indexed cost of the shares in the pool is added to the indexed cost total which is recorded in a separate Indexed Cost column of the share pool. Follow the answer to example 2 below to see how the share pool is constructed.

EXAMPLE 2

A Ltd bought the following shares in B Ltd:

20 August 1989 (RPI 115.8) 1,000 shares at a cost of £5,000
16 November 1996 (RPI 153.9) 2,000 shares at a cost of £12,000
7 October 2014 (RPI 257.7) 500 shares at a cost of £5,000

A Ltd sold 3,000 shares on 10 October 2014 (RPI 257.7) for £36,000
The company has a 31 March year end.

Calculate the gain to include in the Corporation Tax Computation for year ended 31 March 2015.

4 Bonus issues

- (a) A bonus issue increases the number of shares held with no corresponding increase in cost.
- (b) The bonus shares are simply added to the number of shares column in the pool.
- (c) Do not however index the cost of the original shares to the date of the bonus as no new cost is incurred.

5 Rights issues

- (a) A rights issue again increases the number of shares held, but this time there is also a cost associated with the shares. It is therefore dealt with in the same way as any other acquisition
- (b) The indexed cost in the pool is indexed to the date of the rights issue. The rights shares are added to the number of shares column and the cost is then added to both the cost and indexed cost columns in the pool. The only problem you face is computing how many shares are acquired under the rights issue

EXAMPLE 3

Y Ltd acquired 3,000 shares in X Ltd on 20 July 1993 for £10,000. In February 1995 X Ltd made a 1:3 bonus issue. Y Ltd sold 2,000 shares in October 2014 for £12,000.

Calculate the gain on the disposal of the shares in October 2014

RPI are as follows:

October 2014	257.7
February 1995	146.9
July 1993	140.7

6 Takeovers

- (a) Where a takeover is a share for share deal or paper for paper transaction, shareholders of the company taken over acquire shares in the acquiring company. This normally does not constitute a chargeable disposal.
- (b) The new shares are deemed to have been acquired at the same time and for the same cost as the original shares.
- (c) A takeover may involve attributing the cost of the original holding to the different component parts of the new holding, if a mix of consideration is received e.g. a combination of ordinary and preference shares. This is done by allocating the cost of the original holding to the new shares according to their market value at the time of the takeover. See example 4
- (d) If at takeover, cash is received, a chargeable gain needs to be calculated at takeover for the cash element received. See example 5

EXAMPLE 4

Z Ltd acquired 10,000 A Ltd shares in July 1989 for £10,000. In July 2014 B plc takes over A Ltd and for each share in A Ltd, Z Ltd receives:

2 B plc ordinary shares valued at £1.50 each and, 1 B plc preference shares valued at £1 each.

The preference shares are sold in October 2014 for £15,000 and the indexed rise from July 1989 to October 2014 is 1.231

Calculate the Gain arising as a result of the takeover in July 2014, and the sale of the B plc preference shares in October 2014

EXAMPLE 5

Using example 4 what difference would it make if Z Ltd receives at takeover

2 B plc ordinary shares valued at £1.50 each and £1 cash for each share in A Ltd.

The indexed rise between July 1989 and July 2014 is 1.216.

You may now attempt Practice Question 25