

RELEVANT TO ACCA QUALIFICATION PAPER F6 (UK) AND PERFORMANCE OBJECTIVES 19 AND 20

## Groups

*This article is relevant to candidates sitting the Paper F6 (UK) exam in 2012, and is based on tax legislation as it applies to the tax year 2011–12 (Finance Act 2011).*

Groups may be examined as part of question two, or they could be examined in Questions 4 or 5.

### Associated companies

A question may require you to identify the number of associated companies in a group, or it may tell you how many associated companies there are and then ask you to justify this number. When answering this type of question make sure you explain why companies are both included and excluded.

The lower and upper corporation tax limits are divided by the number of associated companies, thus affecting the rate of corporation tax. Do not forget to include the parent company in the number of associated companies.

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### EXAMPLE 1

Music plc has the following shareholdings:

	Shareholding
Alto Ltd	25%
Bass Ltd	60%
Cello Ltd	100%
Drum Ltd	100%
Echo Inc	100%
Flute Ltd	100%

Music plc's shareholding in Cello Ltd was disposed of on 31 December 2011, and the shareholding in Drum Ltd was acquired on 1 January 2012. The other shareholdings were all held throughout the year ended 31 March 2012.

Echo Inc is resident overseas. The other companies are all resident in the United Kingdom.

All the companies are trading companies except for Flute Ltd, which is dormant.

- Alto Ltd and Flute Ltd are not associated companies as Music Ltd has a shareholding of less than 50% in Alto Ltd, and Flute Ltd is dormant.
- Bass Ltd, Cello Ltd, Drum Ltd and Echo Inc are associated companies as Music Ltd has a shareholding of over 50% in each case, and they are all trading companies
- For associated company purposes, it does not matter where a company is resident. Echo Inc is therefore included despite being resident overseas.

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- Companies that are only associated for part of an accounting period, such as Cello Ltd and Drum Ltd, count as associated companies for the whole of the period.
- Including Music Ltd there are five associated companies, so Music Ltd's lower and upper corporation tax limits are reduced to £60,000 (300,000/5) and £300,000 (1,500,000/5) respectively.

### Definition of a 75% group

There are two types of group relationship:

- The 75% group relationship that is necessary to claim group relief.
- The 75% group relationship that is necessary for chargeable gains purposes.

The definition of a 75% subsidiary company for chargeable gains purposes is looser than that for group relief purposes. This is because the required 75% shareholding need only be met at each level in the group structure.

### EXAMPLE 2

Fruit Ltd is the parent company for a group of companies. The group structure is as follows:



For the year ended 31 March 2012 Fruit Ltd has an unrelieved trading loss.

### Group relief

- For group relief purposes, one company must be a 75% subsidiary of the other, or both companies must be 75% subsidiaries of a third company.
- The parent company must have an effective interest of at least 75% of the subsidiary's ordinary share capital.
- The parent company must also have the right to receive at least 75% of the subsidiary's distributable profits and net assets on a winding up.

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- Fruit Ltd will therefore be able to group relief its trading loss to Apple Ltd and Banana Ltd.
- Fruit Ltd does not have the required 75% shareholding in Cherry Ltd (100% x 80% x 80% = 64%).

**Chargeable gains**

- Companies form a chargeable gains group if at each level in the group structure there is a 75% shareholding.
- However, Fruit Ltd, the parent company, must have an effective interest of at least 50% in each subsidiary company.
- Fruit Ltd, Apple Ltd, Banana Ltd and Cherry Ltd therefore form a chargeable gains group.

**Group relief**

Remember that group relief is not restricted according to the percentage shareholding. Therefore, if a parent company has a trading loss then 100% of that loss can be surrendered to a 75% subsidiary company, and if a 75% subsidiary company has a trading loss then 100% of that loss can be claimed as group relief by the parent company.

Unlike other loss relief claims, the claimant company claims group relief against its taxable total profits after the deduction of any gift aid donations.

**EXAMPLE 3**

For the year ended 31 March 2012 Ballpoint Ltd has a trading profit of £510,000, a chargeable gain of £32,000, and paid gift aid donations of £2,000.

Ballpoint Ltd has a 100% subsidiary company, and for the year ended 31 March 2012 claimed group relief of £40,000 from this company.

During the year ended 31 March 2012 Ballpoint Ltd received dividends of £27,000 from an unconnected UK company, and dividends of £18,000 from its 100% subsidiary company. Both figures are the actual cash amounts received.

The corporation tax liability of Ballpoint Ltd for the year ended 31 March 2012 is as follows:

	<b>£</b>
Trading profit	510,000
Chargeable gain	<u>32,000</u>
	542,000
Gift aid donation	<u>(2,000)</u>
	540,000
Group relief	<u>(40,000)</u>
Taxable total profits	500,000
Franked investment income (27,000 x 100/90)	<u>30,000</u>

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Augmented profits	<u>530,000</u>
Corporation tax at (500,000 at 26%)	130,000
Marginal relief	
$3/200 (750,000 - 530,000) \times 500,000/530,000$	<u>(3,113)</u>
	<u>126,887</u>

• Ballpoint Ltd has one associated company, so the upper corporation tax limit is reduced to £750,000 (1,500,000/2).

• Group dividends are not included as franked investment income.

When the accounting periods of the claimant company and the surrendering company are not coterminous, then group relief may be restricted. There may also be a restriction where an accounting period is less than 12 months long.

**EXAMPLE 4**

Sofa Ltd owns 100% of the ordinary share capital of both Settee Ltd and Futon Ltd. For the year ended 31 March 2012 Sofa Ltd had a trading loss of £200,000.

For the year ended 30 June 2011 Settee Ltd had taxable total profits of £240,000, and for the year ended 30 June 2012 will have taxable total profits of £90,000.

Futon Ltd commenced trading on 1 January 2012, and for the three-month period ended 31 March 2012 had taxable total profits of £60,000.

- The accounting periods of Settee Ltd and Sofa Ltd are not coterminous. Therefore, Settee Ltd's taxable total profits and Sofa Ltd's trading loss must be apportioned on a time basis.
- For the year ended 30 June 2011 group relief is restricted to a maximum of £50,000, being the lower of £60,000 ( $240,000 \times 3/12$ ) and £50,000 ( $200,000 \times 3/12$ ).
- For the year ended 30 June 2012 group relief is restricted to a maximum of £67,500, being the lower of £67,500 ( $90,000 \times 9/12$ ) and £150,000 ( $200,000 \times 9/12$ ).
- Futon Ltd did not commence trading until 1 January 2012, so group relief is restricted to a maximum of £50,000, being the lower of £60,000 and £50,000 ( $200,000 \times 3/12$ ).

As well as trading losses, it is possible to surrender unrelieved property business losses and gift aid donations. Only current year losses can be group relieved, so no relief is available for trading losses brought forward from previous years.

In working out the taxable total profits against which group relief can be claimed, the claimant company is assumed to use any current year losses that it has, even if such a loss relief claim is not actually made.

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**EXAMPLE 5**

Lae Ltd owns 100% of the ordinary share capital of Mon Ltd. The results of each company for the year ended 31 March 2012 are as follows:

	<b>Lae Ltd</b>	<b>Mon Ltd</b>
	<b>£</b>	<b>£</b>
Trading loss	(18,100)	(11,200)
Property business profit/(loss)	(26,700)	60,900
Loan interest received	1,600	3,300
Capital loss	(19,200)	0
Gift aid donations	(4,800)	(3,200)

All the loan interest received is in respect of loans that were made for non-trading purposes.

**Maximum claim by Mon Ltd**

- The group relief claim by Mon Ltd is calculated after deducting gift aid donations, and on the assumption that a claim is made for the current year trading loss.
- The maximum amount of group relief that can be claimed by Mon Ltd is therefore £49,800 ( $60,900 + 3,300 - 3,200 - 11,200$ ).

**Maximum surrender by Lae Ltd**

- The property business loss and the gift aid donations can be surrendered to the extent that they are unrelieved, so £29,900 of these can be surrendered ( $26,700 + 4,800 - 1,600$ ).
- It is not possible to surrender capital losses as part of a group relief claim.
- The maximum potential surrender by Lae Ltd is £48,000 ( $18,100 + 29,900$ ).
- The maximum group relief claim is therefore £48,000.

The most important factor to be taken into account when considering group relief claims is the rate of corporation tax payable by the claimant companies. Group relief should therefore be surrendered as follows:

- Initially to companies subject to corporation tax at the marginal rate of 27.5%.
- Surrender should then be to those companies subject to the main rate of corporation tax of 26%.
- The amount surrendered should be sufficient to bring the claimant company's augmented profits down to the small profits rate limit.
- Any remaining loss should be surrendered to those companies subject to corporation tax at the small profits rate of 20%.

The loss making company may of course be able to relieve the loss itself. In this case consideration will also have to be given to the timing of the relief obtained (an earlier claim is generally preferable), and the extent to which relief for gift aid donations will be lost.

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Remember that unlike other loss relief claims, it is possible to specify the amount of group relief that is to be surrendered. The surrendering company can therefore restrict group relief so that it retains sufficient losses in order to bring its augmented profits down to the small profits rate limit.

**EXAMPLE 6**

Colour Ltd owns 100% of the ordinary share capital of both Orange Ltd and Pink Ltd. The results of each company for the year ended 31 March 2012 are as follows:

	<b>Colour Ltd</b> £	<b>Orange Ltd</b> £	<b>Pink Ltd</b> £
Trading profit/(loss)	(135,000)	650,000	130,000
Property business profit	120,000	0	0

Colour Ltd had franked investment income of £10,000.

The corporation tax liability of each of the group companies for the year ended 31 March 2012 is as follows:

	<b>Colour Ltd</b> £	<b>Orange Ltd</b> £	<b>Pink Ltd</b> £
Trading profit	0	650,000	130,000
Property business profit	120,000		
Loss relief	(30,000)		
Group relief	<u>          </u>	<u>(75,000)</u>	<u>(30,000)</u>
Taxable total profits	90,000	575,000	100,000
Franked investment income	<u>10,000</u>	<u>          0</u>	<u>          0</u>
Augmented profits	<u>100,000</u>	<u>575,000</u>	<u>100,000</u>
Corporation tax at 20%	18,000		20,000
Corporation tax at 26%	<u>          </u>	<u>149,500</u>	<u>          </u>

- There are three associated companies in the group, so the lower and upper corporation tax limits are reduced to £100,000 (300,000/3) and £500,000 (1,500,000/3) respectively.
- Colour Ltd's trading loss has been relieved so as to reduce both its own and Pink Ltd's augmented profits down to the lower limit. Note that it is the augmented profits that are relevant, and not the taxable total profits.
- The balance of the loss has been surrendered to Orange Ltd as this saves corporation tax at the main rate of 26%.

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### Chargeable assets

It is important to remember that capital losses cannot be group relieved.

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#### EXAMPLE 7

Why would it be beneficial for all of the eligible companies in a chargeable gains group to transfer assets to one company prior to them being disposed of outside of the group?

- The transfers will not give rise to any chargeable gain or capital loss
  - Arranging that wherever possible, chargeable gains and capital losses arise in the same company will result in the optimum use being made of capital losses.
  - These can either be offset against chargeable gains of the same period, or carried forward against future chargeable gains.
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However, an asset does not actually have to be moved between companies in order to match chargeable gains and capital losses. It is possible for two companies in a chargeable gains group to make a joint election so that matching is done on a notional basis.

The election has to be made within two years of the end of the accounting period in which the asset is disposed of outside the group, and will specify which company in the group is treated for tax purposes as making the disposal.

The advantages of the election compared to actually transferring an asset between group companies (prior to disposal outside of the group) are as follows:

- The two-year time limit for making an election means that tax planning regarding the set off of capital losses and chargeable gains can be done retrospectively.
  - The two-year time limit also means that it is possible for chargeable gains to be treated as being made by the company in the group with the lowest rate of corporation tax.
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#### EXAMPLE 8

Rod Ltd owns 100% of the ordinary share capital of Stick Ltd. For the year ended 31 March 2012 Rod Ltd will pay corporation tax at the main rate of 26% while Stick Ltd will pay corporation tax at the small profits rate of 20%.

On 15 August 2011 Rod Ltd sold an office building, and this resulted in a chargeable gain of £120,000. On 20 February 2012 Stick Ltd sold a factory and this resulted in a capital loss of £35,000.

As at 1 April 2011, Stick Ltd had unused capital losses of £40,000.

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- Rod Ltd and Stick Ltd must make a joint election by 31 March 2014, being two years after the end of the accounting period in which the disposal outside of the group occurred.
- Stick Ltd's otherwise unused capital loss of £35,000 and brought forward capital losses of £40,000 can be set against the chargeable gain of £120,000.
- It is beneficial for the balance of the gain of £45,000 ( $120,000 - 35,000 - 40,000$ ) to arise in Stick Ltd as this company only pays corporation at the small profits rate of 20%.

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### Conclusion

With groups it is important that you know the group relationship that must exist for reliefs to be available. Where a question involves a group you can expect to spend more time than normal planning your answer. However, working through the examples in this article will prepare you for anything that could be set in the examination.

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