*These notes refer to the Corporation Tax Act 2009 (c.4) which received Royal Assent on 26 March 2009*

# CORPORATION TAX ACT 2009

## EXPLANATORY NOTES

### COMMENTARY ON SECTIONS

### Part 3: Trading income

### Overview

### *Chapter 11: Trade profits: valuation of stock on cessation of trade*

### Overview

604. This Chapter sets out the rules for valuing stock when a company ceases to carry on a trade. The rules for valuing work in progress are not rewritten because, for tax purposes, a company cannot carry on a profession (see *Change 2* in Annex 1). If a company has incomplete services when it ceases to carry on a trade they are included in its trading stock (see section 163(2) of this Act) and valued in accordance with the rules in this Chapter.

### *Section 162: Valuation of trading stock on cessation*

605. This section sets out two general propositions. It is based on section 100 of ICTA. The corresponding rule for income tax is in section 173 of ITTOIA. The first proposition is that a valuation has to be made. The second is that the valuation has to be made in accordance with the rules in this Chapter.

606. *Subsection (3)* is the rule for trades carried on in partnership. The general rule in ICTA is that a change in the companies carrying on a trade is treated as the cessation of the trade. But, in the case of a trade carried on in partnership, section 114(1) of ICTA provides that there is a cessation for the purpose of calculating the profits of the firm's trade only if there is a complete change in the companies carrying on the trade.

### *Section 163: Meaning of "trading stock"*

607. This section defines trading stock. It is based on sections 100 and 101 of ICTA. The corresponding rule for income tax is in section 174 of ITTOIA.

608. The definition of trading stock applies:

- in section 151 (sound recordings);
- in this Chapter;
- in section 185 (adjustment on change of basis); and
- in section 195 (post-cessation receipts).

609. Section 101(3) of ICTA is invoked by section 100(2) of that Act and is concerned with valuation of incomplete services "at the discontinuance". So the definition in this section refers to incomplete services "at the time of the cessation".

### *Section 164: Basis of valuation of trading stock*

610. This section introduces the five sections that follow. It is based on section 100 of ICTA. The corresponding rule for income tax is in section 175 of ITTOIA.

611. The five sections (including section 168 which defines "connected persons") deal with the valuation of stock that is transferred to another trader. In each case, the requirement in section 100 of ICTA that the transferee carries on a trade is relaxed to include transfers to a person carrying on a profession or vocation. The income tax rules are amended to bring the income tax and corporation tax codes into line. See *Change 39* in Annex 1.

612. *Subsection (4)* of this section deals with the case where the stock is not transferred to a person carrying on a trade, profession or vocation.

### *Section 165: Sale basis of valuation: sale to unconnected person*

613. This section sets out the rule for the common case where the trading stock is transferred to an unconnected trader. It is based on section 100 of ICTA. The corresponding rule for income tax is in section 176 of ITTOIA.

614. The section leads directly to the use of the sale price of the stock as the basis of valuation. If the transfer is other than by sale, section 170 explains how the expressions used in this section are to be interpreted.

### *Section 166: Sale basis of valuation: sale to connected person*

615. This section sets out the rule for the case where the stock is transferred to a connected person. It is based on section 100 of ICTA. The corresponding rule for income tax is in section 177 of ITTOIA.

616. The section preserves the concept of an arm's length price. This will usually be the same as the open market value (see section 164(4)) but sometimes there will be a difference.

617. For example, in a capital transfer tax case, IRC v Spencer-Nairn [1991] STC 60, the Court of Session considered the meaning of an arm's length price and distinguished it from open market value. This was on the basis that the seller in that case had imperfect information. A sale at arm's length by that seller would not assume that the seller had better information; a sale in the open market would assume perfect information on both sides of the bargain.

618. Furthermore, in the case of an actual sale to a connected trader, there is no need to *assume* there is a sale. It is enough to treat the sale as made at arm's length. This leaves open the possibility that the stock is worth something different from open market value to a person who intends to use the stock in the trade.

### *Section 167: Sale basis of valuation: election by connected persons*

619. This section allows the seller and purchaser of stock that would otherwise be valued at arm's length under section 166 to elect to use instead the price paid for the stock. It is based on section 100 of ICTA. The corresponding rule for income tax is in section 178 of ITTOIA.

620. The election cannot be made unless the arm's length value of the stock is greater than its "acquisition value" in the hands of the seller.

621. The "acquisition value" of the stock for the company which ceases to trade is effectively book value, but the definition in *subsection (5)* is more complicated than this. In the case where the net realisable value of stock has fallen below cost in the period leading up to cessation, a new period is deemed to start just before the deemed sale. That allows the new, lower, net realisable value to be used. It may be possible to manipulate net

realisable value by selling the stock at an undervalue after the accounting date. So paragraph (a) of the definition assumes that the sale is at an arm's length value.

622. The election substitutes the price paid for the arm's length value of the stock. But the price paid must be higher than the acquisition value. Otherwise, the election substitutes the acquisition value for the arm's length value.

623. This section does not specify that the election is to be made to "the inspector". But the general rules about claims and elections in Schedule 18 to FA 1998 require elections to be made in a return or, if that is not possible, to "an officer of Revenue and Customs" in accordance with Schedule 1A to TMA.

### *Section 168: Connected persons*

624. This section provides a definition of connected persons for the stock valuation sections. It is based on section 100 of ICTA. The corresponding rule for income tax is in section 179 of ITTOIA.

625. This section is one of the exceptions to the general rule in section 1258 that a firm is not to be regarded for tax purposes as a separate entity. If a firm is connected with the seller or purchaser of its stock, section 166 (rather than section 165) applies but the firm may make an election under section 167.

### *Section 169: Cost to buyer of stock valued on sale basis of valuation*

626. This section sets out the rule for the buyer of the stock. It is based on section 100 of ICTA. The corresponding rule for income tax is in section 180 of ITTOIA.

627. In a "sale basis" case, the value given to the trading stock of the company whose trade has ceased is also used to calculate the profits of the buyer of the stock.

628. The reference to ITTOIA caters for the case where the stock is acquired from a person liable to income tax. The valuation under that Act for income tax purposes is used as the cost to the buyer who is liable to corporation tax.

### *Section 170: Meaning of "sale" and related expressions*

629. The stock valuation sections refer to a sale of stock. This section explains how the sections are to be interpreted if the stock is transferred other than by way of sale. It is based on section 100 of ICTA. The corresponding rule for income tax is in section 181 of ITTOIA.

### *Section 171: Determination of questions*

630. This section treats any "question" arising under sections 164 to 167 as an appeal (to be determined by the tribunal). It is based on section 102 of ICTA. The corresponding rule for income tax is in section 186 of ITTOIA.