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 14: Adjustment on change of basis

Overview

678. This Chapter sets out the rules for dealing with two sorts of changes in the way profits of a trade are calculated.

679. The first sort of change is in the way the accounts are drawn up. The rule is that profits must be calculated on the basis of accounts drawn up in accordance with generally accepted accounting practice (see section 50 of FA 2004 and section 46 of this Act).

680. If there is a change in the basis on which accounts are drawn up, some receipts and expenses may fall out of account for tax purposes. This sort of change was dealt with originally in the rules that became section 104(4) to (7) of ICTA. Those rules were replaced by the rules in section 44 of, and Schedule 6 to, FA 1998. The 1998 rules were replaced by section 64 of, and Schedule 22 to, FA 2002.

681. The second sort of change is in the way tax adjustments are made. These are the adjustments "required or authorised by law in calculating profits for tax purposes" (section 46). This sort of change was dealt with for the first time by the 2002 legislation.

682. Section 1267 of this Act applies the rules to trades carried on in partnership.

683. The corresponding rules for income tax are in Chapter 17 of Part 2 of ITTOIA. The title of that Chapter is "adjustment income" because there is a charge on such income in section 228(2) of ITTOIA. For corporation tax a positive adjustment is treated as a trade receipt. So the title of this Chapter is more general.

Section 180: Application of Chapter

684. This section sets out the circumstances in which an adjustment may arise. It is based on section 64 of FA 2002. The corresponding rule for income tax is in section 227 of ITTOIA.

685. Section 64 of FA 2002 refers to a change of the basis on which profits are calculated. This might mean *any* change of basis. But paragraph 3(2) of Schedule 22 to FA 2002 makes clear that it does not include a change which occurs on a change of ownership of a trade.

686. The trading income rules in this Part are generally "company-based". So this section applies when *a company* changes the basis. That company must be the same before

and after the change of basis. So this section reproduces the effect of paragraph 3(2) of Schedule 22 to FA 2002.

687. An adjustment has to be made if:

- the "old basis" accorded with the law *or* practice at the time; and
- the "new basis" accords with the current law *and* practice.

688. The difference in wording is to cater for a case in which a decision of the Courts makes it clear that a previously accepted view of the law was wrong. In that case, the old basis accorded with the practice but not the law. The 1998 rules did not cater for this. But the 2002 rules (and the rules in this Chapter) do.

689. The section refers to "a trade". So the rules apply to trades carried on wholly outside the United Kingdom as they apply to trades carried on at least partly in the United Kingdom.

Section 181: Giving effect to positive and negative adjustments

690. This section sets out the treatment of the adjustment. It is based on paragraphs 4 and 5 of Schedule 22 to FA 2002. The corresponding rule for income tax is in section 228 of ITTOIA.

691. If the adjustment is positive it is treated as a trade receipt; if the adjustment is negative it is treated as a trade expense.

692. In both cases the treatment is the same whether the trade is taxable under Case I or Case V of Schedule D in the source legislation. The adjustment is treated as arising on the first day of the first period of account for which the new basis is adopted. This contrasts with the income tax treatment which is that the adjustment arises on the last day of the period (see sections 232 and 233 of ITTOIA).

Section 182: Calculation of the adjustment

693. This section contains the main rules for calculating the adjustment. It is based on paragraph 2 of Schedule 22 to FA 2002. The corresponding rule for income tax is in section 231 of ITTOIA. The section presents the rules as a method statement.

694. In item 3 of each of Step 1 and Step 2 there is a reference to work in progress as an alternative to trading stock. This follows the source legislation and is needed because the extended meaning of "trading stock" in section 163 of this Act does not apply outside Chapter 11.

Section 183: No adjustment for certain expenses previously brought into account

695. This section deals with the case where the old basis of calculation allowed a tax deduction but the new basis requires the deduction to be spread over several periods. It is based on paragraph 6 of Schedule 22 to FA 2002. The corresponding rule for income tax is in section 234 of ITTOIA.

696. In the absence of this section there would be a positive adjustment within item 2 of Step 1 of the calculation of the adjustment in section 182. That would produce the right result overall but the rule would take effect too early. Instead, no adjustment is calculated but no deduction is allowed in future for expenses that have already been taken into account.

Section 184: Cases where adjustment not required until assets realised or written off

697. This section is a timing rule for an adjustment which results from any of the amounts in subsection (2). It is based on paragraph 7 of Schedule 22 to FA 2002. The corresponding rule for income tax is in section 235 of ITTOIA.

698. The amounts in subsection (2) are:

- closing trading stock;
- opening trading stock; and
- depreciation.

699. The general timing rule is that any adjustment is made at the start of the first period of account on the new basis (see section 181(2) and (3)). But any adjustment for stock or depreciation is made when the asset is realised or written off.

Section 185: Change from realisation basis to mark to market

700. This section is concerned with a change from the realisation basis to “mark to market” accounting. It is based on paragraph 8 of Schedule 22 to FA 2002. The corresponding rule for income tax is in section 236 of ITTOIA.

701. “Mark to market” is a basis of accounting used by traders in financial assets. Instead of carrying the assets in the books at cost, financial traders draw up accounts to show the assets at fair value at the accounting date. But for tax purposes the realisation basis may have been used.

702. In the first period in which mark to market is adopted for tax purposes, the opening stock may be valued at a higher (market) value than the closing stock of the previous period. Or a financial asset may have been carried in the accounts at cost but appear as a deduction in a later period at fair value. In either case, there is an adjustment within section 182.

703. As in section 184, the adjustment is postponed until the asset is realised.

Section 186: Election for spreading if section 185 applies

704. This section provides for an election to be made if there is a receipt (following a change to mark to market) under section 185. It is based on paragraph 9 of Schedule 22 to FA 2002. The corresponding rule for income tax is in section 237 of ITTOIA.

705. The election is to spread the adjustment receipt over six periods of account beginning with the first one in which the new basis is adopted. As the receipt is postponed under section 185 until the asset is realised, this first period is not necessarily the one in which the charge would be made without the election.

706. “Period of account” is defined in section 832(1) of ICTA.

Section 187: Transfer of insurance business

707. This section further postpones the charge on an adjustment in the case of assets to which section 185 or 186 applies. It is based on paragraph 10 of Schedule 22 to FA 2002. It is the only section in this Chapter that has no corresponding section in Chapter 17 of Part 2 of ITTOIA.

708. The section applies only to insurance companies. If the asset of an insurance company is transferred to another insurance company in accordance with a relevant transfer scheme, it is not treated as “realised” for the purpose of sections 185 and 186 until it is realised by the transferee company.