# aat

**Lewis Camello**
AAT Student

# Business tax interactive worksheet

# Corporation tax – using the marginal relief formula

The marginal relief formula is one of the more complicated areas of corporation tax and is often tested in the Business Tax assessment.

In this module, we will firstly summarise the key points in applying the formula, work through an example together before you get an opportunity to try an example yourself.

Please remember that you are provided with tax tables in the assessment. These will give you data to help you put your answer together. Here is an extract of the 201G/1H tax tables showing the corporation tax data.

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**Corporation tax**

| | 201F | 201G |
|---|---|---|
| Financial year | 201F | 201G |
| Small profits rate | 2€% | 20% |
| | | |
| Marginal relief: | | |
| Lower limit | £300,000 | £300,000 |
| Upper limit | £1,500,000 | £1,500,000 |
| Standard fraction | 1/200 | F/F00 |
| Main rate | 2Î % | 2I % |

Formula: Fraction x (U – A) x N / A

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**Key points**

1. In the formula set out above:
   U = Upper profit limit
   A = "Profits"
   N = Total Profits
2. Marginal relief applies where the 'profits' of an accounting period of a UK resident company are over £300,000 but under £1,500,000.
3. The corporation tax at the main rate is calculated first before **deducting** the result of the formula. Please remember to deduct the result of the formula – it is a common mistake to add the result of the formula to the corporation tax at the main rate.

4. Profits = Total profits + the grossed-up amount of dividends received from UK companies.
5. The profit limits are reduced for accounting periods of less than 12 months, for example the lower limit for a 9 month period = 9/12ths x £300,000 = £225,000.

## Worked example

Harvey Ltd had a nine month period of account ended 31 December 201G For the period the total profits were £720,000 and Harvey Ltd received UK dividends of £27,000 in the period.

**Calculate Harvey Ltd's corporation tax for the accounting period ended 31 December 201&**

Let's see how to answer this question in simple steps.

**Step 1 – Do we have a small companies rate, full rate or marginal relief question?**

Always check first to see what band the company's profits fall within.

Note that the length of the accounting period is nine months.

So the lower profit limit = Lower profit limit x fraction for period = £300,000 x 9/12 = £225,000

And the upper profit limit = £1,500,000 x 9/12= £1,125,000 = U in marginal relief formula.

Tip: Remember it is the profit figure (A in the formula) that you need to compare with the profit limits.

A = Total profits + the grossed-up dividends received

Grossed-up dividends received in the period

 = Net dividends received x 100/90 = £27,000 x 100/90 = £30,000.

So, A = £720,000 + £30,000 = £750,000

Since A falls within the upper and lower profit limits for the accounting period then we have a marginal relief scenario.

**Step 2 – What are the figures to enter into the small companies marginal relief formula?**

Tip: Use the tax tables to help build up the figures.

Formula: Fraction x (U – A) x N / A

The accounting period is wholly in FY201Gso the fraction = F/F00

N = Total profits= £720,000

A as above = £750,000

U as above = £1,125,000

**Step 3 – Calculate corporation tax on total profits at main rate**

Corporation tax at main rate = Total profits x 24% = £720,000 x 2I % = £1ï GÌ 00

**Step 4 – Calculate marginal relief**

Formula: Fraction x (U – A) x N / A

Marginal relief = F/F00 x (£1,125,000 – £750,000) x £720,000 / £750,000 = £HͿÎ 00

**Step 5 – Deduct the marginal relief from the full rate figure**

Tip: Remember the marginal relief fraction is **deducted** from the main rate figure.

Corporation tax = £17GÌ 00 – £HͿÎ 00 = £1Î J,G00

## Practice question

Biscuit Ltd had the following results for the year ended 30 September 201G

|  | £ |
|---|---|
| Trading profit | 835,000 |
| Rental income | 25,000 |
| Dividends received | 36,000 |

**Calculate Biscuit Ltd's corporation tax for the year ended 30 September 201&**

Note: This accounting period covers two financial years (FY 201F and 201G), this has an effect on the corporation tax calculation since the marginal relief fraction and main rate are different for the two financial years. The profits of the accounting period need to be apportioned between the two financial years on a time basis.

We've set out the calculation in steps to help you.

**When you've attempted each step, you can check your calculation by clicking on the button to reveal the solution before moving onto the next step.**

**Step 1 – Do we have a small profits rate, main rate or marginal relief question?**

Click to display/hide the solution.

**Solution**

Since the profit limits are the same for FY2010 and FY2011, whether we have a marginal relief question can be determined without the need to split the profits between the two financial years.

Always check first to see what band the company's profits fall within.

The length of the accounting period is 12 months.

So the lower profit limit = £300,000 x 12/12 = £300,000

And upper profit limit = £1,500,000 x 12/12= £1,500,000 = U in marginal relief formula

A = Total profits + grossed-up dividends received

= £835,000 + £25,000 + (£36,000 x 100/90) = £900,000.

Since A falls within the upper and lower profit limits for the accounting period then we have a marginal relief scenario.

Hint: you will often find the marginal relief formula produces results that are not round figures. In the assessment, round your workings to the nearest whole £.

**Step 2 – What are the figures to enter into the small companies marginal relief formula?**

Click to display/hide the solution.

**Solution**

Formula: Fraction x (U – A) x N / A

The accounting period is in FY 2010, Fraction = 7/400 and FY2011, Fraction = 3/200

Six months of the accounting period is in FY2010 and six months in FY2011.

N = Total profits= £835,000 + £25,000 = £860,000

FY2010      FY2011
Split: £430,000     £430,000

A as above = £900,000

FY2010      FY2011
Split: £450,000     £450,000

U as above = £1,500,000

FY2010      FY2011
Split: £750,000     £750,000

**Step 3 – Calculate corporation tax on total profits at main rate**

Click to display/hide the solution.

**Solution**

FY2010 Corporation tax at main rate = Total profits x 28% = £430,000 x 28% = £120,400

FY2011 Corporation tax at main rate = Total profits x 26% = £430,000 x 26% = £111,800

**Step 4 – Calculate marginal relief**

Click to display/hide the solution.

**Solution**

FY2010 Formula: Fraction x (U – A) x N / A Marginal relief = 7/400 x (£750,000 – £450,000) x £430,000 / £450,000 = £5,017

FY2011 Formula: Fraction x (U – A) x N / A Marginal relief = 3/200 x (£750,000 – £450,000) x £430,000 / £450,000 = £4,300

**Step 5 – Deduct the marginal relief from the main rate figure**

Click to display/hide the solution.

**Solution**

FY2010 Corporation tax = £120,400 – £5,017 = £115,383

FY2011 Corporation tax = £111,800 – £4,300 = £107,500

Corporation tax for the accounting period = £115,383 + £107,500 = £222,883