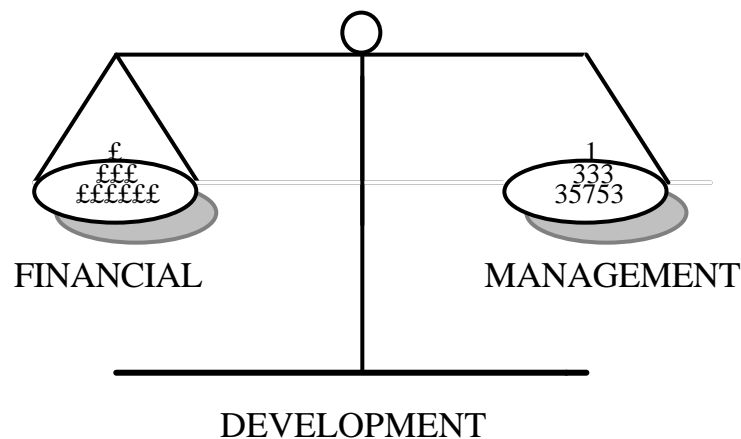


FINANCIAL MANAGEMENT DEVELOPMENT

Taxation

NO 411

CORPORATION TAX



ONE OF A SERIES OF GUIDES FOR
FINANCIAL MANAGEMENT DEVELOPMENT
FROM

www.FinancialManagementDevelopment.com

This is one of a series of documents produced by David A Palmer as a guide for managers on specific financial topics to assist informed discussion. Readers should take appropriate advice before acting upon any of the issues raised.

CORPORATION TAX

WHO IS LIABLE?

Any Corporate body resident in the UK or trading in the UK is liable to Corporate tax. Partnerships, local authorities and charities are specifically exempt.

WHAT IS LIABLE?

The profits of a trade or combination of trades earned in an accounting period - normally twelve months.

AT WHAT RATE?

The current rate is 30% although it has been as high as 52%. There is a lower rate for companies with low taxable profits. Currently those with profits below £300,000 pay tax at 20% and there is a sliding scale up to profits of £1,500,000 above which all profits are charged at 30%.

WHEN IS IT PAID?

Normally nine months after the end of the Company's accounting period, but for large companies this is being changed to a quarterly basis in the next few years.

WHAT ARE TAXABLE PROFITS?

In the majority of cases the profits shown in the profit and loss account will not be the profits on which tax is charged. The main adjustments are:

DISALLOWED EXPENDITURE

1. Capital expenditure.
2. Revenue expenditure not incurred wholly and exclusively for the purpose of earning profits (including appropriate of profit).
3. Expenses applicable to different accounting periods.
4. Items classified as charges on income. (These are deducted on a payments basis separately in the tax computation).
5. Expenditure specifically disallowed e.g. entertaining expenditure (unless it is staff entertainment).

NON TRADING RECEIPTS

1. Capital receipts or profits therefrom.
2. Income assessed under another heading.
3. Income applicable to a different accounting period.

OTHER ADJUSTMENTS

1. Capital allowances are substituted for Depreciation.
2. Allowance of expenditure not charged against profit.

CAPITAL ALLOWANCES

The revenue accept that the use of capital assets should be reflected as a charge against profits subject to taxation. However, they do not accept the depreciation charge shown in the accounts but instead they give capital allowances. There are two types of capital allowances:

Industrial Buildings Allowance Allowances for Plant and Machinery

Note: If a company incurs capital expenditure which does not qualify for capital allowances then it will not get any relief for that expenditure or any associated depreciation.

INDUSTRIAL BUILDINGS ALLOWANCE

To gain an allowance - currently at 4% per year on a straight line basis the building must be in use for a "qualifying activity". Broadly these are activities for the purpose of a trade where goods are stored or subject to some form of processing. Certain buildings are specifically excluded - dwelling houses, retail shops, showrooms and offices. Basically the allowance was designed to help "industrial" companies at the expense of "service" industries. There is an exception to allow the cost of offices etc. if the expenditure on them does not exceed 25% of the cost of the total structure.

ALLOWANCES FOR PLANT AND MACHINERY

There is no statutory definition of plan and machinery but in 1887 it was described as "whatever apparatus is used by a businessman for carrying on his business, not being his stock in trade but all goods and chattels, fixed or movable, live or dead, which he keeps for permanent employment in his business". There are specific areas where the Revenue do not accept items as plant and machinery, e.g. false ceilings, immovable partitions, canopy at a petrol station, spectator stand at football ground, ship used as a floating restaurant, stallion for stud. There are specific allowances for some more esoteric types of plant including patents and "know-how".

Where an item is deemed to be plant and machinery it attracts a writing down allowance of 25% p.a. on a reducing balance basis. (This is reduced to 6% for certain assets lasting over 25 years and small businesses can claim slightly higher rates.) Thus a charge against profits is allowed which is the equivalent of 25% of the tax net book value. The Company's charge for depreciation is, of course, disallowed.

When the item is sold the sale proceeds are deducted from the "pool" of written down values. In many cases the proceeds will be nil. If the asset is sold at a figure greater than its original cost, this will result in a capital gain.

In summary, if a Company incurs expenditure which because of its nature is deemed a "capital" expense and it cannot claim any allowance because the expenditure is not covered by Industrial Buildings or Plant and Machinery criteria, the Company will get **NO RELIEF** for that expenditure.

Thus the preferred order for any spending is:

	Allowance in First Year	Thereafter
Revenue Expense	100%	-
Plant & Machinery	25%	25% WDA
Industrial Building	4%	4% p.a.
Other Capital	0%	0%

THE CORPORATION TAX COMPUTATION

Each corporate entity is required to furnish the Inland Revenue with a tax computation setting out the reported profit in the audited accounts and the adjustments to arrive at the figure on which corporation tax will be payable. It must be emphasised that taxation is an art not a science. Most corporate tax returns are queried by the Revenue and frequently the final tax charge is agreed after negotiation.

A typical computation will have the following:

	£
Pre tax profit per the accounts	
Add disallowed expenditure:	
Depreciation	
Capital expenditure charged against income Note 1	
Expenditure not wholly and exclusively	
for the purposes of the trade Note 2	
Expenditure disallowed by Statute Note 3	
Less Capital allowances	_____
Adjusted trading profit	_____

NOTE 1

There is no reason why the Inland Revenue should agree with the Company's definition of capital versus revenue items. In particular they will not allow legal fees on capital items.

NOTE 2

The not "wholly and exclusively" for the purposes of the trade covers a number of items:

1. Charitable donations (unless small, local, some trade benefit) or political payments.
2. Expenditure to do with raising share capital.
3. Expenditure to do with subsidiary companies.
4. Legal advice and costs to do with taxation disputes.

NOTE 3

Expenditure disallowed by statute includes:

1. Any entertaining (unless only employees are present or it is a training event).
2. Any gifts (unless less than £10, are an advert for the donor and not food, drink or tobacco).
3. Leasing costs of cars which cost over £12,000 are restricted.
4. Any appropriations of profit e.g. dividends paid or general provision made.

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David is an experienced financial professional who has devoted his skills to management training in practical understanding and utilisation of financial information. A Graduate, Chartered Accountant, and Associate of the Institute of Taxation, he is also a Member of the Chartered Institute of Personnel and Development.

He has worked as a Financial Controller and Company Secretary in the Finance Industry and as a Director of Finance and Administration in the Computer Services industry. Since 1990 he has conducted management development programmes for over thirty major organisations including Blue Circle, BP, CSC Computer Sciences, Conoco, Ernst & Young, Lloyds Bowmaker, The Post Office, Rothmans and Zeneca. International training experience includes work in Denmark, Kenya and the Czech Republic for Unilever, in Dubai for Al Atheer, in Holland and the U.S. for Avecia and Zeneca and in Bahrain and Saudi Arabia for Cable & Wireless.

He specialises in programmes in financial management for both tactical and strategic decision making. A key output from the training is demonstrable use of the knowledge and skills acquired to enhance corporate profitability. In addition he has run courses in acquisition evaluation (The Economist, Blue Circle and Hays Chemicals) and in post-acquisition management (Unilever). He has also developed material for delivery by in house personnel (Royal Mail, Lloyds Bowmaker and Conoco) and computer based training packages (The Post Office, Unilever and BP).

He is a prolific writer of case studies, role plays and course material, he has also published articles on the financial justification of training, financial evaluation of IT investment proposals, the use of Activity Based Costing and Customer Profitability statements, commercial considerations for consultants and the need for taxation awareness training for general managers.

He is married with one grown up daughter and his outside interests include being The Treasurer of the Hospice of St. Francis (Berkhamsted), and a member of the Catholic Alpha Training Team (Promoting the Alpha course on Basic Christianity). He was a Governor of Luton University for nine years and a school Governor for four years.

This series of papers is designed to help managers by providing a basic understanding of key financial concepts to assist them in their work. It is provided at no cost since this knowledge is a Gift from God and thus to be shared (Matthew 10:8).