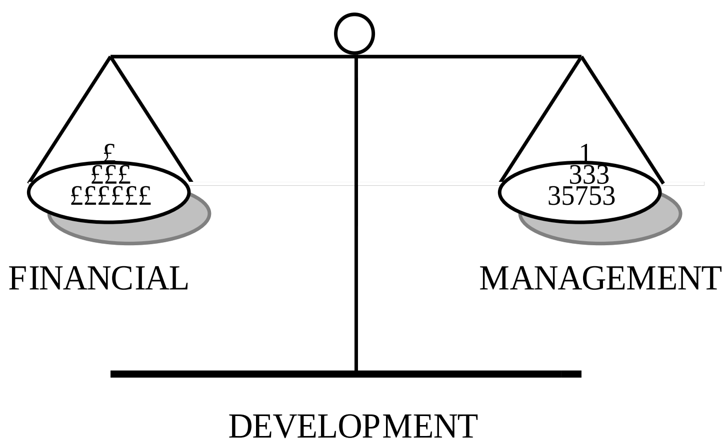
FINANCIAL MANAGEMENT DEVELOPMENT

Taxation

NO 411

CORPORATION TAX



ONE OF A SERIES OF GUIDES FOR

FINANCIAL MANAGEMENT DEVELOPMENT

FROM

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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 Corporation 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 26% 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 26%.

WHEN IS IT PAID?
Normally nine months after the end of the Company's accounting period for small and medium sized companies. For large companies (profits over £1,500,000), there are four quarterly payments starting 6.5 months into the accounting period. There are rules to cope with accounting periods other than a year and to share the limits for groups of companies.

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 appropriations of profit e.g. dividends).
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), the first 15% of car leasing costs for cars of over 160g/km C02.

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. Allowances for expenditure not charged against profit.
3. Tax Credits e.g. for Research and Development in Small and Medium sized companies.

CAPITAL ALLOWANCES

HMRC accepts 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. The main capital allowances are for Plant and Machinery as the allowance for Industrial and Agricultural Buildings was removed in April 2011. There are also some Enhanced (i.e. of more than 100%) Allowances for Research and Development and some 100% First Year Allowances on "Energy saving" capital expenditure. Cars get special treatment and allowances are not available on assets leased rather than bought. 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.

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 may receive an Annual Investment Allowance, any balance unrelieved may then receive a Writing-down Allowance.

The 100% Annual Investment Allowance for expenditure on Plant and Machinery is currently limited to £100,000 (expected to fall to £25,000 in April 2012). If the amount spent is greater (note as usual there are rules for accounting periods under 12 months, years when rates change and for groups of companies) the remainder may receive a Writing-down Allowance currently 20% (expected to fall to 18% in April 2012). There are special rules for cars which do not qualify for the Annual Investment Allowance but receive a Writing-down Allowance of either 20% or 10% (expected to fall to 18% and 8% in April 2012) depending on their CO_2 and the colour of the eyes of the Chancellor of the Exchequer. (Note this last qualification is only expected to be introduced by this commentator - but it is consistent with the logic behind the other changes recently.) 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 in a special pool its disposal may result in a Balancing Charge or Allowance. If the asset is sold at a figure greater than its original cost, this will result in a capital gain and there are separate rules for this.

The Company's charge for depreciation is, of course, disallowed.

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 the above criteria, the Company will get **NO RELIEF** for that expenditure.

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. The simplest way to deal with the computation is to follow the CT600 form provided by HMRC but 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		
Plus Net Chargeable Gains		
Adjusted Taxable Profit	Note 4	_____

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 - but do note these may be Gift Aided.
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 (sic).

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 £50, advertise the donor, not food, drink or tobacco).
3. Leasing costs of cars which have CO_2 emissions above 160g/km are restricted to 85% of the amount paid.
4. Any appropriations of profit e.g. dividends paid or general provision made.

NOTE 4
There are separate rules for the calculation of the tax due on profits on disposal of capital items, including the treatment of capital losses.

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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 and has been an Ordained as a Deacon in the Catholic Church.

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 forty major organisations including Arla Foods, Blue Circle, BP, CSC Computer Sciences, Conoco, Ernst & Young, Lloyds Bowmaker, Royal Mail, Unilever and Zeneca. He also runs programmes for the Leadership Foundation and the management teams at a number of Universities. International training experience includes work in Belgium and Holland for CSC, in Denmark, Kenya and the Czech Republic for Unilever, in Holland and the US for Zeneca, in Dubai for Al Atheer, in Bahrain and Saudi Arabia for Cable & Wireless.

He specialises in programmes in financial management for both tactical and strategic decision making. In addition he has run courses in acquisition evaluation (The Economist, Eversheds, Blue Circle and Hays Chemicals) and in post-acquisition management (Unilever). All training is specifically tailored to the needs of the organisation with the emphasis on practical applications to enhance profitability and cashflow. He has developed material for delivery by in-house personnel (Royal Mail, Lloyds Bowmaker and Conoco), computer based training packages (The Post Office, Unilever and BP), and post course reinforcement self-study workbooks (CSC and Zeneca). He has also produced a training video on Cashflow Management.

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, the need for taxation awareness training for general managers, evangelisation and Christian business ethics.

Many of his generic documents are freely available on his website: **FinancialManagementDevelopment.com** including papers on Charity Management.

In addition to his Diaconal work in the Church, he has held a number of voluntary positions including University, College and School Governor, Hospice Treasurer and Trustee of various charitable institutions. He continues to provide ad hoc commercial advice to several other charitable organisations. He has been married for over 35 years and has one daughter and three granddaughters.

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).
(I wonder how God copes with disallowance of this cost in his Tax Computation?)

