

Introduction to Corporation Tax (UK)

1 The structure of a corporation tax computation

The figure below is a **proforma** for a typical corporation tax computation

Company name	
Corporation tax computation for XX months ending	
	£
Schedule D Case I	X
Schedule D Case III	X
Schedule D Case VI	X
Schedule A	X
Chargeable gains	X
Less: Charges on income (Gift Aid)	(X)
	—
Profits chargeable to corporation tax	X
	—
Corporation tax liability at relevant rate	X
Less Quarterly instalments paid (if applicable)	(X)
	—
Corporation tax payable (repayable)	X
	—

2 The relevance of accounting periods

Length of accounting period

A company prepares a computation of 'profits' for a chargeable accounting period (CAP). In a normal situation, a company prepares a 12 month set of accounts and has a matching CAP. Where accounts are shorter (e.g. 9 months) then there is a shorter CAP.

A CAP can never exceed 12 months. Therefore where the **financial accounting period may exceed 12 months** there is a CAP for 12 months and then a separate CAP for the balance. No other combination is acceptable. Once the profits for an accounting period are determined then that forms the basis for a CT computation.

A **CAP starts** in any of the following circumstances.

- 📅 A company **begins to trade**
- 📅 A company **acquires a source of chargeable income**
- 📅 A **previous CAP ends**

A **CAP ends** on the **earliest date** indicated by the following rules.

- 📅 The **12 months rule**
- 📅 The **date 'accounts' are made up to**
- 📅 The date the company **ceases or begins to trade**
- 📅 The **winding up** of the company
- 📅 The **date** when the company **begins or ceases to be UK resident**

3 Profits chargeable to corporation tax (PCTCT)

Schedule D Case I

The **first stage** of a single company computation is to **ascertain the PCTCT**, comprising **income and gains less charges on income**.

Schedule D Case I comprises the following elements.

Adjusted accounting profit	£ X
Less Capital allowances	
- Plant and machinery (P & M)	(X)
- Industrial building allowances (IBA)	(X)
Add - Balancing charges (excess CA claimed)	X
	<hr/>
Deduct DI trading loss brought forward from earlier CAP	X (X)
	<hr/>
	X
	<hr/>

Specific points relating to companies

The adjusted accounting profit is net profit before taxation as adjusted for tax purposes. Specific points relevant to companies are discussed below.

- ✚ There is **no 'private use' adjustment** for personal expenses or wages and salaries or for capital allowances.
- ✚ A company is likely to reflect all its income in the profit and loss account, and therefore **any investment income has to be removed to arrive at a trading profit**. This will include rental income, bank and building society interest, patent royalty investment income, and dividend income (these are dealt with elsewhere in the computation).
- ✚ **Dividends paid** by a company are **not an allowable trade deduction** but in any event these should **not have been deducted** in arriving at net accounting profit.

Other profits and charges

In ascertaining Schedule D Case I for a company, various items are adjusted for, as they **do not** represent trading expenses or income.

Various types of interest receivable will be included under the heading Schedule D Case III. Exceptionally, interest received on a “**trading**” loan would be shown under **Schedule D Case I** but this would **only apply for money lending trades**.

For this module, you should assume that all interest received by a company is received gross. In all cases it is the **accrued amount** for the accounting period which should be used. Schedule DIII also includes interest payable on a loan to acquire or improve property. This is known as non-trading interest payable and is deducted from Schedule D Case III, on an accruals basis.

Patent royalty income is normally included as trading income (i.e. under **Schedule D Case I**) on an **accruals basis** and **requires no adjustment**. Exceptionally, if the patent rights are held for a non-trade purpose (e.g. as an investment), the income is labelled **Schedule D Case VI**, again on an accruals basis.

Although there are situations where a company receives (or pays) patent royalties **net of basic rate income tax**, for exam purposes you should **assume companies pay and receive patent royalties gross**.

Dividend income is not chargeable to corporation tax and is **ignored** when preparing PCTCT. **Rental income** is included under the heading **Schedule A**, and comprises the following.

	Note	£
(a) Rental income (furnished or unfurnished)	1	X
Less expenses (excluding loan interest payable)	1	(X)
		—
		X
(b) Taxable element of premium on any short lease (less than 50 years)	2	X
		—
		X
		—

Notes

- (1) This is accrued income and expenses for the accounting period.
- (2) This is premium received $\times \frac{51-n}{50}$ where **n = number of years on lease**.

Schedule A Losses

Relief for a Schedule A loss is as follows.

- ✚ A current period loss must be set off against other profits before relief is given for charges on income with any amount which cannot be so relieved being carried forward.
- ✚ A loss which is carried forward must also be relieved against total profits before charges on income of future periods.

Note that Schedule A losses **must** be relieved as above - there is no facility to choose.

Capital gains

A company's PCTCT includes capital gains as well as income.

Current period and brought forward losses are set off **automatically against gains**. Where there is an **excess of capital losses (brought forward or current)** over gains the **balance of the loss can only be carried forward for relief against future capital gains**.

Charges

The final component in finding PCTCT is to deduct from the total profits (income and gains) **any allowable payments known as charges on income**.

For exam purposes you are only likely to encounter charges in the form of **Gift Aid**. **These are non-trade charges in all circumstances**. Patent royalties paid before 1 April 2002 were deducted as trade charges but this is **unlikely** to be examined.

The Gift Aid amount which can be deductible for a CAP is the amount paid, which may be different from the amount accrued in the accounts. The fact that the charge is trade or non trade is significant for loss purposes only.

Comprehensive example

Laserprint Ltd provides the following information for its year to 31 March 2006.

	Note	£
Adjusted trading profit		500,600
Capital allowances		16,000
Rental income (net of expenses)		12,000
Bank loan interest accrued and paid to purchase rental property		4,000
Building society interest (accrued)	1	20,000
10% Debenture Stock interest accrued and received on £60,000 nominal value		6,000
Agency commissions receivable	2	20,000
Gift Aid payment made		14,000

Notes

- (1) The amount actually received was £15,000.
- (2) The agency commissions were not received as part of the company's trading activities and are therefore assessable under DVI.
- (3) There were capital losses brought forward of £2,000.

Required:

Compute the PCTCT for the year ended 31 March 2006, assuming all reliefs claimed as early as possible.

Approach to the example

It is essential to develop a **methodical approach** from the outset in **computing PCTCT**, to enable you to tackle examination level questions later.

Step 1

Set up a skeleton CT computation proforma. Keep this on a sheet of paper to itself.

£

Schedule D Case I (W1)

Schedule D Case III (W2)

Schedule A

Schedule D Case VI

Chargeable gains

Less Charges on income

PCTCT

The **headings are not required** to be in **any particular order** but it is accepted best practice to put DI first.

Step 2

Set up a separate working sheet for any necessary workings and work through the information methodically. Schedule D Case I often (though not in this example) **requires more than one working** for the component parts of:

✚ adjusted profit

✚ capital allowances on plant and machinery etc.

As you complete each working slot the result into the proforma.

Step 3

Show clearly the **use of any available losses brought forward** and where available the **carrying forward position** in compiling step 2.

Solution

Laserprint Ltd

CT computation for the year ended 31 March 2003

	£
Schedule D Case I (W1)	484,600
Schedule D Case III (W2)	22,000
Schedule A	12,000
Schedule D Case VI	20,000
Gains (W3)	Nil

	538,600
Less Charges on income – Gift Aid	(14,000)

PCTCT	524,600

There is the occasional mark awarded for presentation and a clear structured answer gives a good impression with a marker!

Workings

(W1) Schedule D Case I

	£
Adjusted trading profit	500,600
Less Capital allowances	(16,000)

	484,600

In exams take great care not to adjust a profit which has already been adjusted for.

(W2) Schedule D Case III

	Notes	£
Building society interest	1	20,000
Debenture stock		6,000
(10 % × £60,000 = £6,000 gross per annum)		_____
		26,000
Less Loan interest payable – rental property	2	(4,000)

		22,000

Notes

- (1) The accrued figure is the assessable amount, not the paid figure.
- (2) This is not a Schedule A deduction.

(W3) Chargeable gains

There are no gains to utilise losses brought forward of £2,000 therefore carry forward.