Corporate Tax and Tax Computations

Interview preparation summary · AU track

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INT.TC.1.a · The tax computation

Build a corporation tax computation from accounting profit to taxable profit, saying which items are added back, deducted or left alone and why.

A company does not pay tax on the profit in its accounts. Tax law has its own rules for what is taxed and what is deductible, so the computation starts from the accounting profit before tax and adjusts it. Items that tax law does not allow are added back: depreciation (replaced by capital allowances), client entertaining, fines and penalties, and costs that are capital in nature such as the purchase of a building or an extension. Income that is not taxable in the company, such as many dividends received from other companies, is deducted, and income taxed on a different basis, such as a gain on selling property, is taken out and replaced with the tax figure. Capital allowances are then deducted. Most day-to-day costs, such as wages, rent and insurance, are deductible if incurred wholly and exclusively for the trade. The common mistake is to treat the accounts as the tax answer, or to adjust in the wrong direction. Name each adjustment and say which way it moves profit. The rates and rules here are general and described with UK practice in mind; check current rules.

WORKED EXAMPLE: FERNBROOK JOINERY: FROM ACCOUNTS TO TAX

Fernbrook Joinery is an invented company with profit before tax of 640,000 in its accounts. The profit is stated after depreciation of 90,000, client entertaining of 14,000 and a fine of 6,000 for a late delivery under a contract, and it includes 20,000 of dividend income received from an unconnected company. Capital allowances for the year are 120,000. Work out taxable profit and the tax at an illustrative main rate of 25 percent. All figures are illustrative; check current rates.

Answer: Taxable profit is 610,000 and tax at the illustrative 25 percent is 152,500. The net adjustment is -30,000 added to the accounting profit.

> **Interview tip:** Say the starting figure, each adjustment with its direction and a one-phrase reason, then the taxable profit and the tax. Always say which rates are illustrative.

INT.TC.1.b · The tax computation

Explain how capital allowances differ from depreciation and tell a timing difference from a permanent difference, with the effect each has on tax paid over time.

Depreciation is the accounting spread of an asset's cost over its useful life. Tax law ignores it and gives its own relief, capital allowances, which are set by statute and differ by asset type. Some regimes allow a large first-year deduction for plant and machinery and a slower writing-down allowance for other assets, and most buildings get little or none. The two measures differ in timing, not in the long run: over the life of an asset the total allowance equals the cost less any proceeds, as does the total depreciation. That makes it a timing difference, and tax paid is lower early and higher later. A permanent difference never reverses: entertaining is never deductible, and some income is never taxed. Timing differences give rise to deferred tax in the accounts, while permanent differences change the effective tax rate. Candidates often say the allowance is a different amount of depreciation. It is a separate relief. Describe both the first-year effect and the reversal, using illustrative rates and a note to check current allowances.

WORKED EXAMPLE: A MACHINE FOR FERNBROOK JOINERY

Fernbrook buys a machine for 200,000. The accounts depreciate it on a straight-line basis over 5 years. For tax, assume an illustrative first-year allowance of 100 percent of cost, and a 25 percent tax rate. Compare year 1 and the full life, ignoring all other items. Check current allowance rules before relying on this.

Answer: Year 1 tax is 40,000 lower, years 2 to 5 are 10,000 higher each, and the total over five years is the same. The allowance is a timing difference.

> **Interview tip:** Say that allowances replace depreciation, that the two total the same over the asset's life, and that a permanent difference such as entertaining never reverses.

INT.TC.1.c · The tax computation

Explain how a company can use a trading loss, what makes companies a group for relief, and how group relief works and where it is limited.

A company with a tax loss has options, which vary by regime but are broadly similar. It can often set the loss against other profits of the same period, carry it forward against future profits subject to any restriction on the amount that can be used, carry it back for a limited period, or, if it belongs to a group, surrender it to another group company that has profits. Group relief lets the group use a loss where the profit arises, and it saves tax straight away instead of waiting for future profits. A group for this purpose is defined by ownership: in the UK, typically a company is in a group with another if one is at least a 75 percent subsidiary of the other, or both are 75 percent subsidiaries of a third, measured through ordinary share capital and certain other rights. A 60 percent subsidiary is therefore outside it. The relief is also limited to the period in which the companies are in the group, and a payment for the relief of up to the loss surrendered is typically ignored for tax. Describe the test, the saving and the limits.

WORKED EXAMPLE: WHICH SUBSIDIARY CAN USE THE LOSS?

Marlowe Holdings is an invented group. Company A, a 100 percent subsidiary, has a tax loss of 300,000 for the year. Company B, also 100 percent owned, has taxable profit of 500,000. Company C, owned 60 percent, has taxable profit of 400,000. Ignore timing. Using an illustrative 25 percent rate and a 75 percent group test, find the tax saved by group relief and the best use. Check the current rules.

Answer: Surrender the 300,000 loss from A to B, saving 75,000 of tax now. C is not in the group because 60 percent is below the 75 percent test.

> **Interview tip:** State the ownership test first, then the saving as loss x rate, then the time-apportionment and payment points. Say that thresholds differ by country.

INT.TC.2.a · Rates, compliance and advice

Say how corporate residence is decided, how profits are charged at the main and small-profits rates, and when tax is paid and the return filed in broad terms.

A company is taxed in a country mainly because it is resident there. In the UK a company incorporated in the UK is resident, and a company incorporated elsewhere can also be resident if its central management and control is exercised in the UK, which usually means where the board actually takes strategic decisions. A tax treaty can settle a conflict if two countries both claim residence. Corporation tax is charged on taxable profits of an accounting period of up to 12 months, with a main rate and sometimes a lower rate for small profits with a sliding scale between them. Thresholds are often divided between associated companies. A company that is not large typically pays nine months and one day after the period end, and files its return within 12 months of the period end. Large companies typically pay in instalments based on an estimate of the year's profits, so cash tax comes earlier. Late filing and payment bring penalties and interest. These rules are described in general terms; check current rates, thresholds and dates.

WORKED EXAMPLE: A YEAR-END, A PAYMENT DATE AND A FILING DATE

Tarn Valley Components is an invented UK company, with a year-end of 31 March 2027, taxable profit of 300,000 and no associated companies. Assume an illustrative main rate of 25 percent, a company that is not large, payment nine months and one day after the period end and filing twelve months after the period end. Find the tax and the two dates, and say what changes if the company were large. Check the current rules before relying on this.

Answer: Tax is 75,000, payable on 1 January 2028, with the return due on 31 March 2028. A large company would pay by instalments earlier.

> **Interview tip:** Give the tax, the two dates and the reason the payment date comes before the filing date. Always say that the dates and rates are the general UK position and must be checked.

INT.TC.2.b · Rates, compliance and advice

Reconcile the tax charge to the statutory rate, explain what moves an effective tax rate, and describe how a tax adviser weighs tax risk and uncertain positions.

The effective tax rate is the tax charge in the income statement divided by the accounting profit before tax. A reconciliation starts with profit multiplied by the statutory rate, then lists what moves the charge: disallowable expenses raise it, enhanced reliefs and non-taxable income lower it, overseas profits taxed at other rates move it either way, and corrections to earlier years add or remove tax. Timing differences do not change the effective rate once deferred tax is recognised, which is the reason permanent differences are the main reconciling items. An unexplained or large other line is a flag. Tax risk is the chance that a position is challenged and fails, with consequences such as extra tax, interest, penalties and reputation. A good adviser separates a supportable position on the law and facts from an aggressive one, records the basis for the view, and tells the client plainly about the risk. Avoidance within the spirit of the law is lawful; evasion, which is dishonest, is not. Describe the reconciliation line by line and give the reason for each.

WORKED EXAMPLE: RECONCILING HARTWELL TEXTILES' TAX CHARGE

Hartwell Textiles is an invented company with profit before tax of 800,000. The statutory rate is an illustrative 25 percent. The profit is after 40,000 of expenses that are not deductible. The company has an enhanced deduction for research that reduces taxable profit by 60,000, and an adjustment for an earlier year that reduced the charge by 8,000. Build the reconciliation and find the effective tax rate. Check current rates.

Answer: The tax charge is 187,000 and the effective tax rate is about 23.4 percent, below the statutory 25 percent, because the research deduction and the earlier year credit outweigh the disallowable expenses.

> **Interview tip:** Say the reconciliation lines in order, give the direction of each, and say which would recur next year. Then say what you would ask about any large unexplained line.

INT.TC.2.c · Rates, compliance and advice

Outline how research and development relief and other reliefs reduce tax, and explain a tax computation to a client in plain words.

Governments use tax reliefs to steer behaviour. Research and development relief gives extra deductions or credits on qualifying costs such as staff time and materials for projects that seek an advance in science or technology and resolve uncertainty. The claimant must keep project records, and the claim can be reviewed by the tax authority. Other reliefs in outline include capital allowances for investment, reduced rates on profits from patents in some regimes, relief for charitable donations, and group relief. A tax adviser must be able to explain a computation to someone who is not a tax specialist. A good explanation starts with the answer, which is the tax bill and when it is due, then bridges from the profit the client knows to the taxable profit, naming the few items that matter in plain words, and finishes with what the client has to do and any risk. The common mistake is to list every adjustment or use jargon. Rates and reliefs change often, so say which figures are illustrative and tell the client to expect them to be checked.

WORKED EXAMPLE: EXPLAINING A BILL WITH AN R&D CLAIM

Calder Sensors is an invented company that spent 250,000 on qualifying research projects, already expensed in its accounts. Assume an illustrative additional deduction of 40 percent of qualifying spend, a 25 percent tax rate, and nothing else changes. The finance director asks what the relief is worth and how you would put it in two sentences. Check the current rules before advising.

Answer: The additional deduction is 100,000 and the tax saving is 25,000. In plain words: an extra deduction for research spend lowers your bill by 25,000, provided the records support the claim.

> **Interview tip:** Lead with the number, give the reason in a sentence a non-specialist would follow, then state what the client must keep or do. Mention that rates are illustrative.

Summary of the Charta interview-preparation topic. Companies and figures in the examples are invented. Draft content, not yet expert reviewed.