Corporation Tax Computation 7 Steps
Working Solution by Paul McDevitt, FCCA, F2 Examiner, July 2013.

Some students have difficulty in knowing how to deal with 'addbacks' in a corporation tax question. This article, based on Question 2 from the April 2011 Formation 2 Taxation examination paper (see Appendix 1), shows in seven steps how these types of question may be approached. The question used has been updated to reflect current legislation. Readers should note that the question related to a 15 month set of financial statements. This, however, does not affect the addback computations as these are done for the 15 months with the adjusted profit then split into the relevant assessable periods.

1. **Identify profit (loss) per accounts**
2. **Identify addbacks**
3. **Identify deductions**
4. **Calculate taxable trading profit**
5. **Calculate capital allowances**
6. **Assess other income**
7. **Summarise all tax payable**

Step 1 – Identify Profit/(Loss) per Accounts

	€	Notes
Profit (Loss) per Accounts	1,414,600	Ensure you start with the net profit not the gross profit!

Step 2 – Identify Addbacks

	€	Notes
Addbacks		These increase profits to be taxed
Depreciation	88,000	Depreciation is always added back
Pension Accrual	5,000	Pension is only allowable when it is paid in the financial year. Accruals are added back
Motor Lease (1)	1112	Car leases are a specific addback as per Sn377. (This is a common addback that all students should be familiar with).
Motor Lease (2)	4,200	
Patent	20,000	Patents are treated as charges for tax purposes and therefore always added back. (Sn243). When the paid is paid, the paid amount is allowable as a trading charge
Entertainment	1,400	Relates to suppliers n/a
Repairs	71,000	Extension is a CAPEX (45,000) and all general provisions (26,000) are not allowable
Rates	2,200	20% of building is sublet so this 20% of rates is only allowable against the rental income.
Light & Heat	3,800	As above
Mortgage Interest	17,200	As above
Donations	1,200	Political donations are always added back
Reduction in Bad Debts Provision	(13,500)	Any movements in General provisions are either added back or deducted. Movements on specific provisions are fully allowable.
Interest on Late VAT	2,000	Any penalties or fines are not allowed
Lease Interest	24,100	Finance lease interest is added back and then the full lease payment(capital & interest) are allowed as a deduction.
Loss on Disposal	3,000	Not trading loss
TOTAL ADDBACKS	**230,712**	

Step 3 – Identify Deductions

	€	Notes
Deductions		**These reduce profits to be taxed**
Other Income	(44,000)	Taking non trading income out of trading tax computation
Lease Payments	(86,000)	This is the full payment of Capital and Interest
TOTAL Deductions	(130,000)	

Step 4 Calculate Taxable Trading Profit (Loss)

	€	Notes
Net Profit	1,414,600	
Total Addbacks	230,712	These increase profits to be taxed
Total Deductions	(130,000)	These reduce profits to be taxed
Tax adjusted Profit	1,515,312	This is the adjusted profit for the 15 months

The adjusted profit for the 15 months has to be allocated into taxable periods. As in this case when a company prepares accounts for a period that is greater than 12 months then it must split the profit into one 12 month period and another period covering the rest. Therefore, in this question the relevant taxable periods will be the 12 months to 30 September 2012 and then a 3 month period to 31 December 2012.

Y/E 30/09/2012 - 12/15 * €1,515,312 = €1,212,250
P/E 31/12/2012 - 3/15 * €1,515,312 = €303,062

Motor Lease Workings

- Motor Leases (1)
  €5,000 * 27-24 / 27 = €556 * 2 = €1,112
- Motor Lease (2)
  €6,000 * 40-12 / 40 = €4,200

Step 5 – Calculate Capital Allowances

Existing Plant
Year ended 30/09/2012
P&M Cost €123,000
W&T @ 12.5% €15,375

Existing Plant
Period ended 31/12/2012
P&M Cost €123,000
Disposal (€15,000)
€108,000
W&T @ 12.5% €24,563 * 3/12 = €3,375

Disposals
The plant sold in October 2012 is in the 3 month period 31/12/2012 and therefor the balancing charge applies in that period only.

Machine	Cost	€15,000
TWDV		€9,375
Disposal		€6,000
Balancing Allowance		€3,375

Therefore total capital allowances for the 3 month period will be €3,375 + €3,375 = €6,750

Step 6 – Assess other income

- Other Income
  The other income in this question is rental income. It is important to remember that we added back items in our adjusted profit computation as they were to do with this rental income and they will be therefore be allowable deductions against this rental income:

	(€)
Rent Received	44,000
Rates	(2,200)
L&H	(3,800)
Interest	(17,200)
Case V	20,800

- Other Income

  The Rental Income has to be split into the two taxable periods on a time basis;

Y/E 30/09/2012	€20,800 * 12/15 =	€16,640
P/E 31/12/2012	€20,800 * 3/15 =	€4,160

Step 7 – Summarise Tax Computation

CT Computation for p/e 31/12/2012

	(€)
Case I	303,062
Cap Allow	(6,750)
Case I	296,312
Case V	4,160
Total Income	300,472
Charges	
(Patent Paid)	(18,000)
Taxable Income	282,472

Tax @ 12.5%*€278,312 =	€34,789	Tax @ 25% * €4,160	=	€1,040

Appendix:

2. Eire Inc. is a company involved in the financial services sector. Eire Inc. has decided to change it's financial year from the 30th September to the 31st December. It's Statement of Comprehensive Income for the period ended 31st December 2012 is as follows:

	Notes		**€**
Gross Profit			2,696,100
Expenses			
Wages & Salaries	1	790,000	
Pension Costs	1	35,000	
Entertaining	2	7,000	
Cleaning		9,000	
Rates	3	11,000	
Bank Charges		6,500	
Donations	4	2,000	
Bad & Doubtful Debts	5	15,000	
Light & Heat	3	19,000	
Telephone & Postage	6	17,800	
Printing & Stationery		11,000	
Repairs & Maintenance	7	76,000	
Motor Expenses	8	90,000	
Legal & Professional Fees	9	9,100	
Patent	10	20,000	
Depreciation		88,000	
Loss on the disposal of fixed assets	11	3,000	
			1,209,400

Operating Profit		1,486,700
Other Income	12	44,000
Interest Payable	13	(116,100)
Net Profit		1,414,600

Notes:

1) Eire Inc. is owned by Brian Gowan, who works full-time in the company. Wages & salaries include Brian's salary of €110,000. The company operates a pension for Brian. The accounts include an accrual of €5,000.

2) Entertaining is made up as follows:

	€
Staff Christmas party	5,600
Christmas Gifts for Suppliers	1,400
	7,000

3) Eire Inc. sublets 20% of it's building to Eurozone Limited. 20% of the rates and light and heat are attributable to the let portion of the building.

4) Donations are made up as follows:

	€
Donation to Green Party	1,200
Donation to eligible charity	800
	2,000

5) The bad and doubtful debt charge is made up as follows:

	€
Increase in specific bad debt provision	27,000
Reduction in general bad debt provision	(13,500)
Bad debt written off	1,500
	15,000

6) Included in the telephone charge is Brian's mobile phone bills, amounting to €1,700. 45% of his calls are private calls.

7) Repairs and maintenance are made up as follows:

	€
Extension to trading premises	45,000
General Repairs	5,000
General Provision repairs to be carried out next year	26,000
	76,000

8) Motor expenses include the following:

	€
Lorry running expenses	68,000
Running costs of executives cars note (a)	15,000
Running costs of Brian Gowan's car note (b)	7,000
	90,000

(a) Eire Inc. leases Mercedes cars for it's executives. During the period 31st December 2012, the company leased 2 cars. Each car had a market value of €27,000 and both were a class A CO2 emissions. Lease payments of €5,000 for each car were made in the period.

(b) Brian Gowan has a company car. The car was leased in September 2012. It had a Market Value of €40,000. It is a Class D emissions car. Lease payments of €6,000 were made in the period. Brian was not previously provided with a company car.

9) Legal & professional fees are made up as follows:

	€
Legal claim by staff for unfair dismissal	4,100
Legal fees re bad debt collection	5,000
	9,100

10) The company have a 20 year patent agreement for a product that they manufacture. The annual charge for the patent is €16,000.The company paid €18,000 in patent fees in December 2012.

11) The company sold some plant in October 2012 for €6,000. The plant was purchased in May 2009 for €15,000. The NBV at the date of sale was €9,000.

The TWDV at 1st October 2011 of plant & machinery was €78,000 (Original cost €123,000).

12) Other Income is the rental income received by the company for sub-letting the property.

13) Interest payable is made up of the following:

	€
Mortgage Interest on property loan (note a)	86,000
Bank Interest on company overdraft	4,000
Interest on late payment of VAT	2,000
Lease Interest (note b)	24,100
	116,100

(a) This is a mortgage on the business property.
(b) Lease payments (capital & interest) paid by the company for the period ended 31st December 2012 were €86,000. €10,000 of this relates to the car leases referred to in note 8 (a) above and €6,000 relates to Brian Gowan's car.

REQUIRED:

Calculate the corporation tax liability of Eire Inc. for the accounting period ended 31st December 2012.

[Total: 20 marks]

SOLUTION 2

Adjusted Profit Computation

Net profit per Accounts			1,414,600	½ mark
Addbacks				
Pension accrual		5,000		1 mark
Entertaining		1,400		½ mark
Rates		2,200		½ mark
Donations		1,200		½ mark
Reduction in bad debts		(13,500)		½ mark
Light & Heat		3,800		½ mark
Repairs & Maintenance		71,000		1 mark
Motor Expenses	(a)	5,312		1 ½ marks
Patent		20,000		½ mark
Depreciation		88,000		½ mark
Interest on late VAT		2,000		½ mark
Interest on loan 20% rented		17,200		½ mark
Lease Interest		24,100		½ mark
Loss on disposal		3,000		½ mark
			230,712	
Deductions				
Other income		44,000		½ mark
Lease Payments		86,000		1 mark
			(130,000)	
Adjusted Profit			1,515,312	
Year end 30th September 2012 12/15 *1,515,312 =			1,212,250	1 mark
Period end 31st December 2012 3/15 * 1,515,312 =			303,062	½ mark

(a) Motor Leases

$5,000 * \frac{27-24}{27} = 556 * 2 = 1,112$

$6,000 * \frac{40-12}{40} = 4,200$

Capital Allowances

Existing

Year ended 30/09/2012

123,000 * 12.5% = 15,375 ½ mark

Period ended 31st December 2012

123,000 - 15,000 = 108,000 * 12.5% * 3/12 = 3,375 1 mark

Balancing Charge

30/09/2009	15,000 * 12.5% =	1,875
30/09/2010		1,875
30/09/2011		1,875
TWDV 01/10/2011		9,375
Sale Proceeds		(6,000)
Balancing Allowance		3,375	1 mark

Capital Allowances p/e 31/12/12 3,375 + 3,375 = 6,750

Rental Income

Rent received	44,000	
Rates	(2,200)	
Light & Heat	(3,800)	
Interest	(17,200)	
Case V	20,800	1 mark

Y/E 30/09/12 12/15 * 20,800 = 16,640
P/E 31/12/12 3/15 * 20,800 = 4,160

Corporation Tax Computation for the year ended 30th September 2012

Adjusted Profit	1,212,250	
Capital Allowances	(15,375)	
Case I	1,196,875	
Case V	16,640	½ mark
Total Income	1,213,515	
Tax at 12.5% 1,196,875@ 12.5%	149,609	½ mark
Tax at 25% 16,640@25%	4,160	½ mark
	153,769	

Corporation tax for the period ended 31st December 2012

Adjusted Profit	303,062	
Capital Allowances	(6,750)	
	296,312	
Case V	4,160	½ mark
	300,472	
Patent	(18,000)	1 mark
	282,472	
4,160 @ 25%	1,040	½ mark
278,312 @ 12.5%	34,789	½ mark
	35,829	