

ECONOMIC AND FISCAL CONCEPTS OF INCOME IN THE UNITED KINGDOM

by A. W. Clements

There is considerable truth in the statement that while accountants, economists and tax experts (both in Government service and in commerce), are concerned much of the time with the concept of "income", all three groups would find it very difficult to supply an all-embracing definition of the word. The aim of this article, following on the introduction by Wisselink, is to see what light is thrown upon the subject by considering how the fiscal concept of income in the U.K. compares with that of the accountant and the economist. Throughout we will restrict our attention to problems of corporate income only.

It is necessary to begin by stating, in very general terms, how an economist views "income". To the man in the street, income is what he can spend during a period and still be as well-off at the end, in the sense that none of his capital will have been consumed. This intuitive approach to income corresponds fairly closely with that of the economist - Hicks, for example, has defined income by using this "well-off-ness" approach. Thus, on this basis, the income of a company is the amount it can pay out in dividends during a period and be as "well-off" at the end of the period as it was at the start.

But attempts to measure business income on this ideal basis run into difficulties. Obviously, in order to calculate income by this method one must first calculate capital and, for this purpose, it is no use relying on the historical costs of resources utilised - capital or equity can only be valued by reference to future receipts. This valuation, however, involves making assumptions about the rate of interest and the level of prices, and here it is difficult to obtain consensus of opinion. Possibly for this reason economists have also defined income or profit in another way - namely as "revenues" less expenses, or factor costs as the economist calls them. At this point, it is worth recording the obvious, that the economist is interested in building a theory which will explain how a firm, in a given market situation, will develop in the long run; and, on the basis that the aim will be to maximise profits, an elegant analysis of profit itself, and of the way in which it should be measured, can be built up. But the emphasis is on theory and on what will tend to come about in the long run.

There can be no doubt, however, that this alternative approach of the economist to profit is much closer to that of the accountant or auditor. He sees his main responsibility as informing both investors (or owners) and management about the profitability and value of the firm in which they are involved. In order to do this, the accountant calculates profit in the following way - transactions between the company and other persons are recorded at their exchange prices, with the result that "revenue" for the accounting period is market value of "sales", while "costs" consist of outgoings incurred as a result of those sales, or as a result of decisions to carry on operations during the period (e.g. administrative costs), or it consists of other outlays which cannot be related to future periods. It is clear that the accountant's profit or income, though also defined as the difference between revenues and costs, is a much more objective concept than that of the economist, and so is the accountant's measure of capital - the historic "money

capital". There is, for example, no theoretical assumption in it that under perfect competition profit will tend to be simply fair wages plus rent plus interest to the owners for the services rendered by them, as there is in the economist's version. The accountant is concerned only with the short run profit, with what has been earned in the year with which he is concerned.

To what extent is the accountant in his approach bound by principles laid down in law? In the first place, it is rare for the Articles of Association of a company to lay down guidelines for the computation of profit. But in the U.K., a number of Acts of Parliament, culminating in the Companies Act 1948, have had as one of their main objects the protection of the owners of a company by providing for those who manage the business - the directors - to supply them with the information which will enable them to check on the stewardship of the directors. To this end, the Companies Act 1948 lays down certain minimum requirements for books of account, balance sheets and profit and loss accounts. Every company is required to keep proper books of account - but the "proper" form of accounting is left to the company. The basic theme of the Act emerges in the concept that the books should be such as are necessary to give a true and fair view of the state of the company's affairs. However, in the words of Professor Gower, at this point the Act "adds little or nothing to the common law and equitable obligation to account which would in any case bind the directors in the capacity of fiduciary agents, or to the sanction of commercial proceedings against the directors if, on liquidation, inadequate accounts should prove to have been maintained."

The same theme emerges in the Act's requirements as regards the balance sheet and the profit and loss account. The former must give a true and fair view of the state of affairs of the company at the end of its financial year - detailed requirements are set out in the 8th Schedule to the Act. Similarly with the profit and loss account - it must give a true and fair view of the profit or loss for the financial year, and certain details must be given - investment income, depreciation, taxation and auditors' remuneration, as well as notes on the basis of taxation, depreciation provisions and any unusual transactions or changes in the basis of accounting.

It is clear that while the Act calls for certain details and, as far as the balance sheet is concerned, has the objective of preventing both "window dressing" and the establishment of secret reserves, it by no means lays down a complete philosophy of accounting. (These is, of course, a new Companies Bill before Parliament at the moment, which provides for the disclosure of additional information, but there is no radical change in the basic principles of the Companies Act itself.) Many of present day generally accepted accountancy principles are the product of the history of the profession. Thus, the emphasis on giving an account of the stewardship of managers to owners, and on ensuring that owners' capital remains intact, has resulted in the following conventions

- a) only realised sales or gains are recognised - unrealised gains, such as increases in the price of stocks still held, are not included in profit;
- b) capital gains generally are not treated as profit, but capital expenditure is gradually written-off against profits, provided the purpose of the expenditure is to produce income;
- c) liabilities generally are shown at their full or true value, assets at historic cost

(less depreciation) or, in the case of stocks, at market value if lower and, in the case of trade debts, at estimated realisable value, if lower.

This brief picture of the accountant's approach to income, based as it is partly on the requirements of the law and partly on the way in which accounting science has developed, is inevitably considerably over-simplified and glosses over those areas where there is debate among accountants. Many, for example, are not satisfied with the concept of historic cost - witness those companies which have "revalued" their assets to take account of inflation - and others have argued against the principle of not recognising unrealised gains. Moreover, modern techniques of management accounting are doing much to modify these conventions.

If one had to select the major areas where such accountants would like to see improvements, and also where economists feel that the normal accounting conventions fall short of what is required to give a "long run" measure of profit, I think one would have to choose -

- 1) the valuation of assets - here the improvement would be to use current prices, wherever these are reasonably obtainable. There would be an effect on the measure of income via depreciation charges and, of course, where the asset is stock in trade ("unrealised gains"). The tendency would be to bring valuation of assets on a historic cost basis more into line with the economist's concept of value as the present worth of future receipts, and
- 2) changes in price levels - here the improvement would be to remove from profits apparent gains arising from inflation, bringing a measure of income in monetary terms into line with a measure in "real" terms.

In the remainder of this article the "economic concept of income" will be used in this sense.

Finally, it remains to be said that while accountants and economists often find it possible not to place a precise valuation on outstanding assets or contingent liabilities, this is not possible in the field of taxation, where a profit must be struck for each and every year or period. This means that the tax rules must be precise - hence many of the differences which do arise with both the accountant's and economist's standpoints.

Income and Capital

Before considering the fiscal concept of income in the U.K. in detail, it is necessary to mention one general way in which, historically, it has differed from the economic concept. Lord Macnaghten's famous dictum delivered in 1901: "Income Tax, if I may be pardoned for saying so, is a tax on income. It is not meant to be a tax on anything else" sums up the traditional rule that income must have a source (invested capital, or labour, or both), and that accretions to the source (growth of the source, or capital gains) are not taxable - only what "comes in" separately from the source is taxable. Accounting convention, as we have seen, tends to follow the same line of thought, but it is in direct contrast with the attitude of the economist. Time and economic necessity have, however, eroded this fiscal concept. As late as the end of the Second World War, it could still be said with accuracy that a trading company could not be taxed on the capital gain arising on the sale of an asset which did not form part of its circulating capital.

But since then, over two decades, a series of complex provisions - the system of capital or depreciation allowances which introduced "balancing charges" to recover excess depreciation on the sale of an asset and the taxation of lump sums received for the sale of patent rights, a mass of legislation dealing with the activities of those who attempted to disguise income as capital gains, such as "stock strippers", the Short Term Capital Gains Tax of 1962, the provisions taxing lease premiums in 1963, and finally the Capital Gains Tax of 1965 - has changed the picture to such an extent that now it can be said that capital gains are taxable and capital losses are allowable.

The Subject Taxed

We are immediately brought face to face with a conflict between economic and legal concepts when we ask: "What is it that is the subject of corporate taxation? Is it the entity as recognised by the law - the separate company - or does tax law take into account the true economic status of the company when it is a member of a group?" Many legally independent corporations are, of course, no more than branches of their parents, and there is no doubt that from the economic point of view they ought to be "integrated" or "consolidated" with other members of the group for tax purposes. The Companies Act recognises this economic fact - when a company controls other companies, group accounts must be prepared so as to give a true and fair view of the holding company plus its subsidiaries. The fiscal advantage conferred by such integration or consolidation is that losses incurred by some members can be immediately relieved against profits made by other members, and systems of integration or consolidation are well developed in Europe in the tax laws of Germany and the Netherlands.

In the U.K. it was possible under the Profits Tax law (the final rate for this tax was 15 %) for parent companies to elect to be taxed together with one or more of their subsidiaries as a group (Finance Act 1937, Section 22). The grouping notice, which could not be revoked, covered only companies resident in the U.K., and only those companies in which the holding of the parent (direct or indirect) amounted to at least 75 % of the ordinary stock. There has never been any possibility of making a similar group election for Income Tax (the final year for which companies are liable to Income Tax is 1965/66, at a rate of 41.25 %). Since Finance Act, 1953, however, it has been open to companies within a group (again the 75 % interest is necessary) to offset losses against profits by means of what are called "subvention payments". Briefly, a company with a "surplus" computed according to the rules of Section 20, Finance Act 1953, can make a payment to a company with a "deficit", and the payment will be treated as a trading expense of the one and a trading receipt of the other. Since Profits Tax profits were, to a large extent, based on Income Tax profits, these "loss relieving" payments were also effective for Profits Tax. This Income Tax scheme is continued for the Corporation Tax, with a few adaptations. The "group concept" is also carried into the Long-Term Capital Gains Tax in the sense that assets may be moved around within a group without "capital gains" arising.

The English method of recognising the economic fact that subsidiaries may well be little more than offshoots of their parent has the advantages of flexibility - it does not have to be used every year, it does not have to be used for every loss, and it is not as rigid in its application to the parent and its subsidiaries as in, say,

Germany - it can apply, for example, as between two subsidiaries, with the parent left out.

Statutory Definition and General Scope

There is nothing in U.K. tax law to correspond with, for example, the German definition of income, which provides for a comparison of net worth at the end and start of the year, and for the proper observation of the regulations concerning business expenses, valuation of assets and allowances for depreciation or depletion, as well as for the drawing-up of financial statements according to the rules of commercial accounting. The position in the U.K. remains as described by Lord Macmillan in 1935 - "The Income Tax Acts nowhere define "income" any more than they define capital; they describe sources of income and prescribe methods of computing income, but what constitutes income they discreetly refrain from saying . . . It is, therefore, to the decided cases that one must go in search of light". The new Corporation Tax has not changed the situation, for while the new tax will be charged for each accounting period of a company on the full amount of the profits arising in that period, the amount of any income for the purposes of Corporation Tax is to be computed in accordance with income tax principles - in short, the new tax depends on the old.

If tax law in the U.K. differs from that of Germany and some other European countries as regards a definition of income, it is similar in that the profit concept depends to a considerable extent on "normal commercial principles". A number of tax cases have made it clear that in the first instance income must be computed on normal commercial principles and in accordance with accountancy practice. Tax law is only invoked when there is some statutory rule which overrides ordinary commercial practice, or when it is considered necessary to introduce a presumption of law because the facts cannot be ascertained. Thus, in a leading case on the problem of stock valuation, experts' views were eventually set aside by the Privy Council - the courts may disregard accountancy practice where it appears to them to be based on a mistaken view of the law.

We have mentioned already, in a very general way, the subject of capital gains. European tax systems generally follow the economic concept of income and recognise as part of profit the increase in the net worth of the company, including all realised capital gains (adjustments are, of course, made for capital introduced or withdrawn). As in the U.S.A., where capital gains have always been part of income but have benefited from the application of a lower tax rate, there has been a tendency to afford liberal treatment to such gains - either a reduced rate of tax, or an exemption from tax provided the gain is re-invested in a certain manner. In the U.K. the introduction of the Long Term Capital Gains Tax has coincided with that of the Corporation Tax, and the net effect is that companies will not pay a lower rate of tax on capital gains than on other income - both will be liable to the Corporation Tax. There are, however, provisions somewhat similar to those in France and Germany, under which, provided the proceeds of sale are re-invested in other assets of the same class, it will be possible to postpone payment of Capital Gains Tax indefinitely. The assets covered include land, buildings, plant and goodwill.

Apart from the relief afforded by these so-called "roll-over" provisions, companies will also for some time benefit from the fact that the major element in

capital gains will not be taxable because it will have accrued before 7th April 1965. Long Term Capital Gains are to be computed either by comparing cost with sale proceeds and then treating as the gain only the proportion of the difference arising after 7th April 1965 on a time basis, or by comparing the value at 7th April 1965 with sale proceeds. Thus in a considerable number of cases it will continue to be worth while for some time to distinguish capital receipts from normal trading or income receipts.

It is not possible in the space of this article to do more than indicate a few of the situations in which disputes have arisen between taxpayers and the authorities as to whether a receipt is "capital" or not. Sales of secret processes or "know-how" have been held in one case to be capital and in others, income; compensation received for the cancellation of a trading contract or the premature termination of an agency agreement may be capital when the rights surrendered constitute the whole, or virtually the whole, of the structure of the firm, revenue otherwise; compensation for the destruction or sterilisation of an asset, although calculated on the basis of the profit the company would have earned had the asset been worked, has been held to be capital; consideration for an undertaking not to compete can be capital when the agreement is struck in isolation, but if it is simply part of an agreement for obtaining supplies the consideration can become revenue; and finally, but probably most important of all in practice, a sale of some or all of the assets of the company, including shares in other companies, gives rise to a capital receipt except to the extent that a profit is made on circulating capital, such as stock-in-trade, and except to the extent that the consideration takes a revenue form, such as a commission or a royalty.

The Timing of Profit Realisation

As regards the timing of profit realisation, tax practice in the U.K. falls somewhere between the view adopted by the economist and the practice of the accountant. Tax law recognises that income does not arise until goods have been delivered or services rendered - when these conditions are fulfilled a figure of remuneration must be credited, so that there will be a proper matching of expenses and revenue, even though payment by the customer may be deferred until a later period. Physical payment may well be merely the realisation of what has already been brought to account.

This goes some way towards the economist's attitude - he would attempt to recognise all economic factors which have contributed to the increase in the net worth of the company during the relevant period - but it is not quite so conservative as the approach adopted by the accountant. While accountants bring in sales or remuneration on the basis outlined above, it is common to make a reserve for bad debts as a percentage of the total amount of the debts. This, no doubt, stems from their "law of conservatism", which urges them never to over-value assets while giving full recognition to liabilities. Tax law, however, does not recognise a general bad debts reserve - only debts proved to be bad, and doubtful debts to the extent that they are estimated to be bad, may be deducted.

Tax law also tends to differ from accountancy practice in that it is well established that when the ultimate receipt in respect of a transaction turns out to be greater than the original estimate, it is possible to re-open the accounts of the earlier period and tax the receipt in that period.

It is, perhaps, worth noting that both Revenue practice and tax law recognise that in special circumstances special rules need to be applied. Thus in the case of Credit Traders, where costs of collection of debts are considerable, the rule that while bad debts may be deducted the future costs of collecting the good debts may not, is waived to some extent. Secondly, a number of cases concerning buildings and land developers show that where the course of trading produces receipts which cannot be expected until well into the future it is appropriate to credit not the full face value of the receipt but its present value. Thus, Lord Atkin in *Abraham v. Talbot* - "To my mind to treat money to be paid twenty years hence as producing a profit this year equal to money in fact paid this year is to produce a completely unreal conception of yearly profit..." Thirdly, traders selling goods on hire purchase terms may either adopt some reasonable method of spreading the profit over the term of the agreement or, if the total amount payable under the agreements entered into during the year is treated as a sale, they may deduct a reserve equal to the gross profit included in the instalments unpaid at the end of the year.

Tax practice does not, however, go so far as to equate with the economic standpoint as far as the timing of profit realisation by a group of companies is concerned. Inter-company transfers can result in profits being shown, without there being a profit to the group as a whole - to the extent that the goods involved are in stocks and have not been sold to outsiders. In this situation, there is no economic profit and here accountants fall in line with economists and recognise the position by setting up some sort of a provision against the profit. However, unless the goods can be transferred back, tax law insists on the profit being brought in.

Expenses

One would expect that while the economist and accountant would be concerned to see that, sometime during the life history of a company, all expenses incurred should be deducted, tax law, concerned as it is with taxing business income, would limit allowable expenses to those occasioned by the business, leaving other expenses, such as those created by the receipt of, for example, investment income, to be dealt with in other ways. This is certainly the case in the U.K. where the general rule is that while the balance of profit is arrived at in accordance with the ordinary principles of commercial trading, i.e. by deducting from receipts expenses deductible on commercial lines, the expenses so deductible are limited to those incurred for the purpose of enabling the company "to carry on and earn profits (of the trade)". Thus, the cost of tax appeals and penalties incurred as a result of illegal trading have been held to be disallowable. On the other hand, in special circumstances, payments with a political flavour can be allowable.

In view of the omnipotence of the source theory in U.K. taxation, and the importance of the "Income or Capital" test as regards receipts, it is not surprising to find that a very large number of tax cases have turned on the same issue as regards expenses. A general rule which is widely quoted runs... "expenditure... made, not only once for all, but with a view to bringing into existence an asset or advantage for the enduring benefit of trade... is capital." But closer examination of the cases reveals that the general rule is not so useful as it might seem; indeed, learned judges have admitted that, in borderline cases, attempts to find a logical dividing line are well-nigh futile. As in the case of receipts, it is unlikely

that the introduction of the Long Term Capital Gains Tax will make it less important, for some time to come, for companies to succeed, in borderline cases, in proving that an expense is revenue rather than capital. Although expenditure incurred on creating or improving an asset, or on defending the company's title to it, will be deductible in arriving at the taxable gain, it will pay a company to obtain an immediate allowance rather than a future one, i.e. on the "disposal" of the asset in question.

Possibly the area in which the major difference between the economic and fiscal views arises is that of liability reserves. Liabilities to third parties which are uncertain as to basis or amount, or items which will not give rise to an outlay or a liability to third parties, would generally be charged as expenses and set up as liability reserves by accountants, and of course, they would be taken into account by economists. The fiscal attitude is, however, much more severe. It was thought, until the case of *Southern Railway of Peru v. Owen* that for tax purposes no provision could be made for what was only a contingent liability. That case established that such a liability may be an allowable expense provided it passes two tests - that the profits for the year can only be stated adequately if the liability is included, and that the methods of established accounting practice and the circumstances of the case make it possible for a reliable figure to be supplied. Unfortunately, it is very difficult in practice to do just that - in the *Southern Railway of Peru* case the taxpayer lost, although the company's auditor testified that he "would not have signed the balance sheet without a qualification unless the aforementioned provision had been made". Any taxpayer hoping to establish a successful case on this basis has to have a very carefully prepared claim, because obviously the courts will not give way to the accountant's views unless the evidence is extremely convincing.

There are, however, special cases where contingent liabilities have been allowed as expenses, principally because of the special nature of the trade. Fire insurance underwriters may deduct a fixed percentage of premium income to cover unexpired risks; life assurance companies may calculate their profits on an actuarial basis, and dealers in trading stamps may deduct an estimate of their liability in respect of unredeemed stamps.

None of these, however, alters the general taxation rule that an expense may only be deducted in the period in which it is incurred. Thus, where a mine was damaged by flooding and it was impossible to repair it during that year because of a strike, the repairs being carried out in the following year, it was held that the expense although certain in amount at the end of the first year, could not be deducted until the second, the year in which it was incurred. In adhering as rigidly to this attitude as it does, U.K. tax law differs to a marked degree not only from the practice of accountants (in the case quoted a "proper provision" was set up in the first year) and the attitude of economists, but also from the taxation systems of several European countries, where provisions for expenses (albeit uncertain in amount) which can be said to have been occasioned by events in the accounting period, e.g. deductible taxation liabilities arising in the year, costs arising from lawsuits in process, and even in some cases deferred maintenance and reserves against risks normally insured, may be deducted for tax purposes.

Valuation of Current and Fixed Assets

While U.K. tax law makes no attempt to lay down any such general principle as that profit should be calculated by comparing valuations of overall net worth at the end and beginning of any period, it remains true that the bases of valuation adopted for balance sheet purposes are of great importance. This is in spite of the fact that the commercial balance sheet has not the same authority in the U.K. as it has in several European countries for tax purposes where, for example, tax depreciation may not exceed commercial depreciation - which means, in effect, that the latter is made to equal the former! In the U.K. the importance of balance sheet valuations, on the other hand, really stems from the rule that the ordinary principles of commercial accounting must prevail except when the law says to the contrary.

Thus, as regards stock-in-trade, tax law follows accounting practice in adhering to the principle that the basis of valuation should be the lower of historic cost or market value, but when one turns to a consideration of the rule for identifying historical cost one finds differences between the two approaches. Thus *Patrick v. Broadstone Mills Limited* and *Minister of National Revenue v. Anaconda American Brass Limited* show that the courts are prepared to reject methods of stock valuation quite acceptable to accountants, and the effect is that for all practical purposes both "base stock" and LIFO methods are ruled out. The results of the elevation of the FIFO method to virtual omnipotence in this field is that, in a period of continuous inflation, the company pays tax on maximum profits, and there is no possibility, as there is elsewhere in Europe, of setting up tax-free reserves in times of rapidly spiralling prices. The major problem in the case of work-in-progress has been, and remains, whether or not the valuation should be restricted to prime cost. The Revenue lost the case of *Ostime v. Duple Motor Bodies Limited*, in which this problem was the point at issue, but it cannot be said that in every case it is no longer necessary to include overheads in the valuation of work-in-progress. Rather has the case emphasised the importance of applying consistent accounting methods, provided they do not lead to silly results, such as an increase in profits during a slack period!

Turning to the valuation of fixed assets, it is probably fair to say that, largely because of the lack of unanimity of opinion on the question of amortisation, tax law has cut through the jungle by developing over a period of time its own rules. At times, these have been dictated by considerations of equity, at others by considerations of national economic policy, and the result now is that the taxation system cannot be said to be based on either accounting or economic concepts of the values of assets.

It is only possible here to indicate a few of these differences. Part X of the Income Tax Act 1952 makes it possible for a great deal of capital expenditure to be allowed as a deduction over a number of years, but neither commercial buildings nor goodwill, not even the acquisition cost, may be so dealt with. Normal depreciation follows principles which are now fairly generally recognised in Europe as regards timing, rate and method. Accelerated depreciation in the U.K., however, has been somewhat exceptional in that not only have companies been able to claim the well-known Initial Allowances (generally 10 % of Cost for Plant, 5 % for Industrial Buildings) but also Free Depreciation (in effect the

balance of cost) in the case of new plant in special Development Districts (areas of high unemployment). These allowances have been made available to encourage investment and to guide it into particular channels - obviously where such considerations are paramount both economic and accountancy principles may be completely disregarded.

The general effect of such forms of accelerated depreciation is to defer tax liability - insofar as true income is distorted, it is distorted as between one year and another, not for all time. It is possible, however, to grant tax depreciation allowances which involve a virtual break with the accountant's balance sheet, in the sense that historical cost, as the basis of depreciation charges, is abandoned, and some part of the accountant's profit goes completely untaxed. The result is generally achieved either by permitting revaluation of assets, with subsequent increases in depreciation, or by granting investment allowances - in effect, bonus depreciation. The purpose of the former can be said to be genuinely to compensate for the decline in value of money; the purpose of the latter is much more mixed, encouragement of investment probably being its main *raison d'être*, but there is no doubt that one of its major results is compensation for the effects of inflation. In the U.K. no attempt has been made to make use of the revaluation method, but investment allowances have been in vogue from 1954 until early this year. The final rates were 30 % of new plant and 15 % of new industrial buildings. While there is no doubt that investment allowances mean that taxable income does, to some extent, conform with economic concepts, this form of compensating for inflation is generally regarded as rather crude. Economists in general would probably prefer to see continuous or frequent revaluation on the basis of index numbers. In fact, criticism of investment allowances gained ground - it was felt that businessmen did not take them into account sufficiently in their investment decisions - until in January 1966, together with the Free Depreciation allowances, they were withdrawn and replaced by the new Investment Grants - cash grants of 20 % or 40 % for certain assets, which will reduce the capital cost for calculating depreciation allowances. Where the grant is given, the Initial Allowance also has been withdrawn; where it is not given (chiefly plant not used in manufacturing or the extractive industries) the Initial Allowance has been increased.

Dividends

A major problem arises when one considers a situation in which one company receives dividends from another company - should the dividends form part of the recipient company's taxable income, or not? The position in the U.K. until the Finance Act 1965 was that dividends received from other U.K. companies were, for Profits Tax purposes, deemed to be "franked investment income", i.e. not liable to Profits Tax, and for Income Tax purposes, deemed to be already taxed (because the company paying the dividend had either in fact, or notionally, paid Income Tax on its profits) and, therefore, not taxable again. The position now is that Profits Tax comes to an end; that companies are liable only to Corporation Tax, and not Income Tax, on their profits, and that dividends received are not included in Corporation Tax profits. When paying dividends, however, companies must deduct Income Tax (at the standard rate of 41.25 %) and hand it over to the Revenue. If another company receives the dividend, there is the possibility of an election to have the dividend paid gross, either where the paying company is a

subsidiary of the other (a simple majority of voting power suffices for this purpose), or where it is a special type of "joint venture" company, known as a "consortium company". In other situations, the recipient company will receive a net dividend, after deduction of what is, in effect, a withholding tax of 41.25 %, but it will be able to use the Income Tax suffered in this way to reduce the Income Tax it has to pay to the Revenue on its own dividend distributions. Thus, the effect is that in each case - gross dividend and net dividend - the receiving company effectively has full use of the gross dividend.

It is interesting to note that this virtual exemption of inter-company dividends does not depend on a minimum qualifying investment in the affiliated company, nor on a minimum holding period. To some extent, however, it does depend on redistribution of the dividend - if the recipient company's own distributions are less than the dividends it receives, it is left bearing some Income Tax on the excess, unless the dividends received are from a subsidiary or "consortium company". However, it is possible to carry this excess forward as a set-off against future Income Tax payable by the company on its distributions, or to claim a repayment of the Income Tax by utilising certain forms of relief (trading losses, certain capital allowances, etc.).

Thus, while the U.K. has now switched over to a tax system in which company and shareholder are treated as separate tax-paying units, it has recognised the economic necessity of not subjecting profits to double or triple taxation as they pass through companies on their way to individual shareholders. In one other respect, too, there has been reasonably full recognition of economic fact - scrip issues or stock dividends are not treated as "distributions" (with one or two exceptions), and thus are not subject to Income Tax in the hands of the shareholder.

This favourable treatment of dividends received by one company from another does not extend, however, to dividends received from overseas companies. These, regardless of the share interest of the U.K. company in the overseas company, are subject to the new Corporation Tax. Relief for overseas taxes - both taxes on the dividend and taxes in the profits of the dividend-paying company - will be available under either Double Taxation Agreements or the Unilateral Relief provisions.

Conclusion

Enough has probably been said about the difference between the concepts of income as used by economists, taxation experts and accountants to show that the situation may be likened to one in which the three experts stand at the three corners of a triangle, each some distance from the other, but with the possibility of a meeting-point in the middle. And true enough, in the middle there is common ground for all three, but just about all that one can say about it is that all three, in their concepts of income, do use the idea that income is somehow a receipt of a benefit. We have seen how the differences which do exist arise as a result of the different purposes for which income has to be computed in each case. Accountants have had the task of computing each and every year, and in a reasonably short space or time, a figure which can be used for the purpose of an equitable share out between loan creditors and shareholders of various types. This has meant that they have had to devise workable conventions which, though rough and ready, do achieve a practical result, and do not introduce any major subjective element

into the calculations. It has long been recognised that when a major event in the company's life, such as a sale of the business, or a take-over bid, comes along, the figures of profit and capital produced by the accountant prove to be inadequate because items such as goodwill and increases in the value of assets have been omitted. The economist might claim that he does take such items into account, but he has the advantage that he is much less concerned with the practical problem of producing a figure of profit in the short run - he is more interested in the theoretical concept of fair profit in the long run. The tax expert finds himself trying to handle a concept which is nowhere defined in the taxing Acts, which is the momentary end product of a slow growth of law over a century or more, and which bears all the marks of the varying relationships between the State and its citizens. We have outlined briefly the ways in which the fiscal version of income differs from both the accountant's and the economist's, not only as regards its general scope, but also as regards the entity involved, the timing of profit realisation and expense deduction, the scope of liabilities included and the valuation of assets. The conclusion which emerges is that, even more than the accountant's concept, the taxation version of income is no more than a reasonable working approximation, and that when one bears in mind its different purpose (the settlement of claims by the State on its citizens, rather than the division of benefits between parties brought together in law), and its different history, this is not at all surprising!