

Transition: Change of Date - Practical Concerns (Lecture B1318 – 11.21 minutes)

Michelle is a self-employed electrician and keen sailor. Her annual profits before capital allowances are £60,000, which accrue at a rate of £2,000 pm from April to September (when she spends a lot of time on the water) and £8,000 pm for the other six months of the year. She has negligible other income.

She has a December year-end and in the transition year to the new basis of assessment (2023/24) decides to change her accounting date to 31 March (which the new rules allow to be treated as a 5th April year-end, thus avoiding the need for ongoing apportionment of profits from two different accounting periods each tax year). She has £3,500 of overlap profits being carried forward from commencement of trade.

Two separate sets of accounts

If she makes up two separate sets of accounts, her results will be:

- y/e 31 December 2023: £60,000;
- 3m to 31 March 2024: $[(3 \times £8,000) - £3,500] = £20,500$.

The latter are 'transition profits', which do not count as adjusted net income for PA abatement nor High Income Child Benefit Charge (HICBC) purposes. They are subject to automatic spreading over 5 years starting in 2023/24, so that only £4,100 will be subject to income tax in 2023/24, in addition to the £60,000 from the standard basis period. The income tax liability on the transition profits will be calculated as the difference between the tax liability (with the inclusion of the transition profits) and the liability with the transition profits excluded.

Suppose she spends £18,000 on a new van during the 15 months and claims annual investment allowance (AIA). If the van is bought in the 12m period, the standard basis period profits will reduce to £42,000. She may therefore want to elect out of the full spreading to bring more transition profits into charge and use up her basic rate band. The expenditure will also save her being subject to the HICBC if she has any qualifying children.

If instead the van is purchased in the 3m to 31 March 2024, the AIA will reduce the transition profits to £2,500 and the standard basis period profits will be unaffected. Thus, she will have reduced the profits that are being spread, so it is clearly beneficial to buy the van in the preceding 12-month period.

Long period of account

What would happen if, instead, she changed her accounting date by making up a 15-month set of accounts to 31 March 2024? In this situation, the profits after capital allowances are time-apportioned to get a split of the standard basis period profits and the transition profits. The profits after capital allowances ($£60,000 + £24,000 - £18,000 = £66,000$) are therefore split as follows:

- Standard basis period: $£66,000 \times 365/456 \text{ days} = £52,829$
- Transition basis period: $£66,000 \times 91/456 \text{ days} = £13,171$.

The overlap profits (£3,500) are deducted from the transition basis period to give transition profits of £9,671, which will be spread over 5 years. Thus, her taxable profits for 2023/24 will be £52,829 plus £1,934 = £54,763. She remains a higher rate taxpayer (despite her purchase of the van) and may be subject to the HICBC, based on her adjusted net income of £52,829.

Note that these accounting date issues need to be considered before capital expenditure is incurred and before the accounts are signed off. *Rupert Grint v HMRC [2019] UKUT 0028* confirmed both that the actual accounts cannot be substituted by different ones for tax purposes and that a set of accounts exceeding eighteen months is ineffective for change of accounting date purposes.

Contributed by Kevin Read