

Choosing Your Accounting Date

Choosing your Accounting Date

Q: Can I select any date for my accounting year end?

A: Yes

The choice of a year end accounting date is for the business owner to decide.

Under the current year basis, the taxable profit for a particular tax year is determined by the accounts that end in that year.

Thus, for 2020-21 tax, accounting dates will vary between 6 April 2020 and 5 April 2021. So, what is the best date to choose?

Sometimes, compelling commercial reasons relating to the nature of the trade will dictate the most appropriate accounting date. Otherwise (as in so many tax matters), there is no easy answer - it all depends on the particular circumstances. There are several basic considerations:

Overlap relief

The system is designed so that, over the life of a business, tax is paid on no more and no less than the cumulative profits of the business. However, unless your accounting date falls between 31 March and 5 April (inclusive), there will be some element of double counting, or overlap, in the first full tax year on the current year basis.

Overlap relief will be held in reserve for use when the business ceases (or on an interim change of accounting date). One concern is that, because of inflation, overlap relief will be worth less in future years than it is at present.

Bunching of terminal profits

The converse of the overlap situation is the 'bunching' effect of profits when a business ceases. The assessment for the final tax year will be based on the profits right back to the accounting date in the previous tax year. The earlier in the tax year the accounting date falls, the longer will be the period of account relating to the final assessment.

Thus a cessation date of, say, 31 December means that the final tax assessment will be based on a period varying in length between 9 months (5 April accounting date) and 21 months (6 April accounting date). This effect may be lessened to some extent by overlap relief, but the overall distortion is illustrated in the example set out below.

Partnerships

Partners are each deemed for tax to have an individual business so the points already mentioned for new businesses and those ceasing apply equally to partners joining or leaving a continuing partnership.

Pattern of profits

If profits do not vary significantly from one year to the next, the accounting date will not affect the assessable profit for each tax year.

Where profits show a trend, the rule of thumb is that (all other things being equal) it is beneficial to have an accounting date early in the tax year if profits are rising, and late in the year if profits are falling.

External factors

Of course, all other things are not equal, and in evaluating the advantages and disadvantages of particular accounting dates there are a number of factors to be considered, including:

- interest rate movements
- the effects of inflation
- changes in rates of tax
- changes to the tax system

No one can say how these will change over time, and so, not surprisingly, businesses tend to be swayed by the short-term advantages, which have at least some degree of predictability.

Timing of payments on account

It is as well to remember that the date for the first payment on account falls just over two months before an accounting date of 5 April, but nearly ten months after an accounting date of 6 April. Thus, with an accounting date later in the tax year you could pay too much tax on account where profits are falling, and this is a further factor affecting cashflow.

EXAMPLES

On the following page, there are examples of the effects of the two extreme accounting dates (5 April and 6 April) in one situation where profits are rising consistently, and another where profits are falling consistently.

The figures relate to two businesses, which starts on 6 April 2019 and cease on 31 December 2024, with profits derived from the accounts as follows:

	A	B
Year ending 5/6 April 2020	£50,000	£95,000
“ 2021	£60,000	£85,000
“ 2022	£70,000	£80,000
“ 2023	£80,000	£70,000
“ 2024	£90,000	£60,000
Period ending 31 December 2024	£75,000	£35,000
Total	£425,000	£425,000

The assessable profits will be as follows (for the sake of simplicity the effect of the odd extra day in the first period has been ignored):

Business A (rising profits)

Tax year	Assessable profit (£)		Difference (£)
	Year end 5 April	Year end 6 April	
2019/20	50,000	50,000	-
2020/21	60,000	50,000	(10,000)
2021/22	70,000	60,000	(10,000)
2022/23	80,000	70,000	(10,000)
2023/24	90,000	80,000	(10,000)
2024/25	75,000	115,000	40,000
Total	425,000	425,000	-

Business B (falling profits)

Tax year	Assessable profit (£)		Difference (£)
	Year end 5 April	Year end 6 April	
2019/20	95,000	95,000	-
2020/21	85,000	95,000	10,000
2021/22	80,000	85,000	5,000
2022/23	70,000	80,000	10,000
2023/24	60,000	70,000	10,000
2024/25	35,000	-	(35,000)
Total	425,000	425,000	-

Of course, the total assessable profits are the same in each case, and equal to the total profits derived from the accounts. The variations arise because of timing differences in the assessment of tax.

These assessment timing differences will obviously affect the tax payable on the normal payment dates of 31 January and 31 July each year. It is therefore vital to consider the implications of these cashflow differences in assessing the advantages and disadvantages of particular accounting dates.

Conclusion

Using a 5 April (31 March) accounting date leads to the simplest application of the current year basis of assessment. However, it does mean that the timetable for tax payments and returns is very tight, and there is therefore an increased risk of incurring penalties. Also, there is now less time to allow for tax and business planning relating to tax issues.

If you expect your profits to show an overall upward trend, there are clearly cashflow advantages in having an accounting date at or shortly after the beginning of the tax year. In these circumstances, it is important to ensure that you make proper provision for the increased liability that will occur when the business ceases.

Do call us if you would like further help or advice on this subject.

Exeter Michael House Castle Street Exeter EX4 3LQ T: 01392 211233	Barnstaple Millennium House Brannam Crescent Roundswell Business Park Barnstaple EX31 3TD T: 01271 342233	Bovey Tracey The Steam Shop Pottery Road Bovey Tracey TQ13 9TZ T: 01626 200124	Holsworthy 12 The Square Holsworthy EX22 6DL T: 01409 253620	Honiton Office 6 East Devon Business Centre Heathpark Way Heathpark Industrial Estate Honiton EX14 1SF T: 01392 211233	Okehampton 4 Fore Street Okehampton EX20 1AD T: 01837 52485
---	---	--	---	--	--

info@simpkinsedwards.co.uk

www.simpkinsedwards.co.uk

Please note: The above resource is provided for general information only. No responsibility can be accepted by Simpkins Edwards LLP for any use made of the information presented, whether acting or refraining from action as a result of the material published. No action should be taken without consulting a professional adviser.