CHAPTER 6

OVERLAP RELIEF AND CLOSING YEAR RULES

Statutory references are to ITTOIA 2005 unless stated otherwise

6.1 Overlap

ITTOIA 2005, s. 204

You may have spotted that "overlap" was an issue when we looked at the opening year rules in the previous chapter. Overlap of profit arises in the opening years of assessment, where the trader is **taxed twice on the same profit**. This arises unless the trader makes up his accounts to 5 April (or 31 March which the Revenue treat as being the same as 5 April).

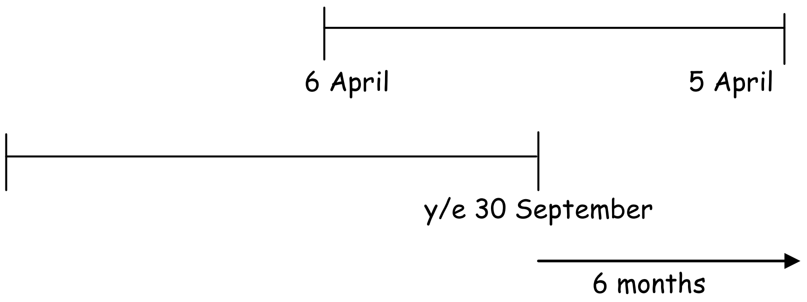
A trader should not pay tax on more profit than he has actually made. Therefore overlap profits will be **relieved** when either:

1) the trader **ceases** to trade, or
2) when the trader **changes his accounting date closer to 5 April** going forward in time. More on this in a later chapter.

We must keep a record (a memo) of the overlap profits arising in order to ensure it is correctly relieved at the appropriate time.

6.2 Computing overlap profit

Overlap profit (also known as overlap relief) is simply the profit arising in the periods when one basis period overlaps with another. The **number of months in the overlap period** will be the **number of months between the chosen accounting date and the following 5 April, moving forwards** in time.



If a trader has chosen a year end of 30 September, there are **6 months** between the year end and 5 April in the next year. Therefore a trader with a September year end will have accrued 6 months worth of overlap profit in the opening years of trade.

Example 1

If a trader has the following year ends, how long will his overlap period be?

a) 31 January year end

b) 30 April year end

Example 2

Sebastian started trading as a plumber on 1 January 2009 and made up accounts as follows:

	£
7 m/e 31.7.09	14,000
Y/e 31.7.10	18,000

Answer the following questions to determine his Trading Income assessments.

a) What is the first tax year of trading?

b) What is the basis period for that first tax year?

c) How much profit has been earned in that period?

d) Year two is tax year 2009/10. Is there an accounting period ending in the second tax year and if so, how long is it?

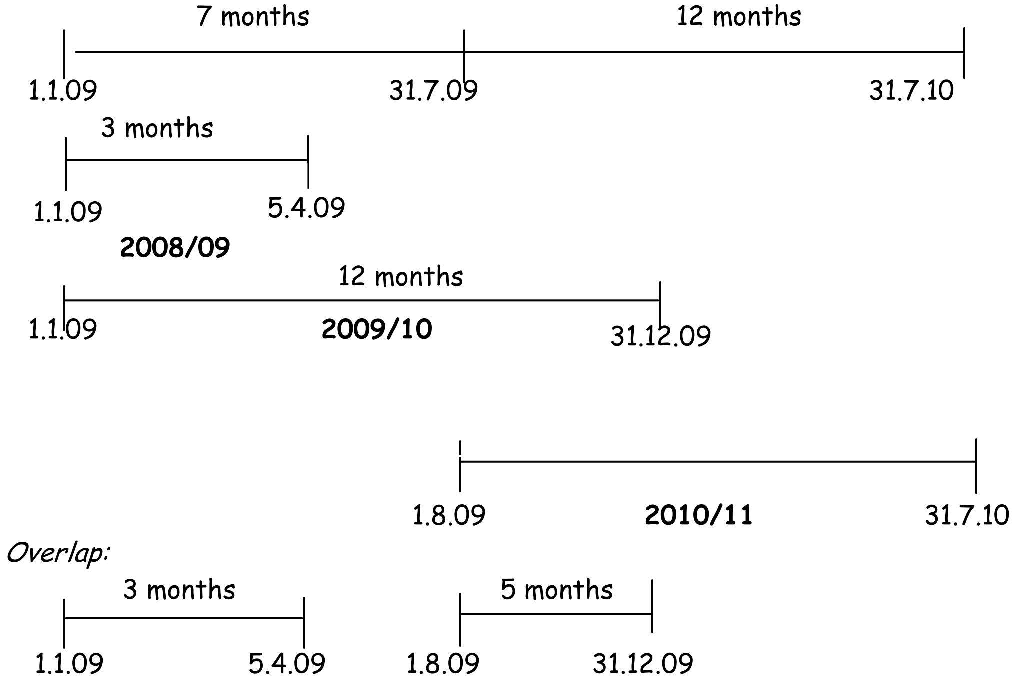
e) What is the basis period for the second tax year?

f) What is the profit earned in that period?

g) Year three is 2010/11. What is the basis period and the profit?

h) How many months worth of overlap are we expecting Sebastian to have?

Looking in detail at Sebastian's overlap position:



			£
First overlap period			
1.1.09 – 5.4.09 =	3 months	$\frac{3}{7}$ x £14,000	6,000
Second overlap period			
1.8.09 – 31.12.09 =	5 months	$\frac{5}{12}$ x £18,000	7,500
Total overlap relief (8 months)			£13,500

Example 3

Milly started trading as a hairdresser on 1 February 2010 and made up accounts as follows:

	£
16 m/e 31.5.11	40,000
Y/e 31.5.12	24,000

Answer the following questions to determine her Trading Income assessments and her overlap.

a) What is her first tax year of trading?

b) What is Milly's basis period for that first tax year of trading and what is the profit arising?

c) The second tax year of trading is 2010/11. Is there an accounting period ending in this second tax year, and if so how long is it?

d) What is the basis period for the second tax year of trading and what profit has been earned?

e) Year three is 2011/12. What is the basis period and what is the profit?

f) How much overlap are we expecting in months?

g) Show the assessments which have arisen in the first three years in a timeline diagram and calculate the overlap period and the overlap profit.

6.3 Checking overlap profit

There is a quick double check we can make with regard to the overlap profit. We can simply add up the assessments (ie, the amount of profit on which the trader will pay tax) and deduct the profits earned. In the last example, Milly's assessments in the first three tax years were as follows:

		£
Assessments:	2009/10	5,000
	2010/11	30,000
	2011/12	30,000
		65,000
Profit earned in period		(40,000)
Profit "double counted"		£25,000

The profit double counted is £25,000 as we identified in the last example.

6.4 Transitional overlap profit

ITTOIA 2005, Sch 2 Para 52

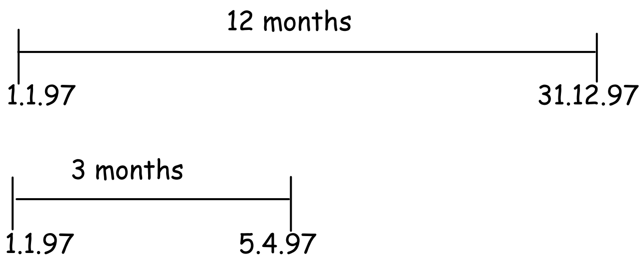
Transitional overlap profit only applies to traders who started trading **before 6 April 1994** (before the CYB rules were introduced).

Transitional overlap is **not real** overlap profit – ie no profits have actually been double taxed. Transitional overlap relief is **notional** (ie, "pretend"), but nonetheless it is **still deducted from the final year's assessment**, or on a change of accounting date.

The transitional overlap period is the **portion of the basis period for 1997/98 that arose before 5 April 1997**. Profits are taken before capital allowances.

Illustration 1

For a taxpayer with a December year end, under CYB rules the 1997/98 basis period would have been the year ended 31 December 1997.



If that particular accounting period showed a profit of £30,000, the portion of that basis period which arises before 5 April 1997 is the three months from 1 January 1997 to 5 April 1997. Consequently the **transitional** overlap will be

$$3/12 \times £30{,}000 = \underline{£7{,}500}.$$

Example 4

A trader has a 30 April year end. Profits in the year ended 30 April 1997 were £36,000.

Calculate the transitional overlap period and the amount of the overlap profit.

6.5 The Closing Year Rules

ITTOIA 2005, s. 202

These rules apply when a trader ceases to trade.

Closing year rules are much simpler than the opening year rules. When looking at closing year rules, we first look at the **penultimate year**, which is the tax year prior to the cessation of the trade. In that period we tax profits using normal CYB rules, ie taxing profits of the 12-month accounting period ending in the penultimate tax year.

In the **final tax year**, we tax the profits arising in the period from the **day after the previous basis period ended to the date of cessation.** In other words, on cessation of trade we tax any remaining profits, making sure there are no gaps or overlaps. We then **deduct the overlap profit brought forward**, whether this is "real" overlap as a result of the opening year rules or "transitional" overlap as a result of the transitional rules. Either way, overlap profits are fully deductible in the final tax year of trade.

Illustration 2

Jerry normally makes up accounts to 31 December each year. He ceased trading on 30 June 2010. His accounts, as adjusted for tax purposes, showed the following profits:

	£
y/e 31.12.09	25,000
6 m/e 30.6.10	10,000

First we identify the tax year of cessation. Jerry ceased trading on 30 June 2010 which is in the tax year 2010/11. The penultimate year of assessment is therefore 2009/10.

Penultimate Year:

2009/10

CYB	y/e 31.12.09	£25,000

The final tax year is 2010/11. The basis period is the day after the end of the previous period to the date of cessation.

Final Year:

2010/11	£
1.1.10 – 30.6.10	10,000
Less: overlap profit (assumed)	(6,000)
Taxable trading profits 2010/11	£4,000

Illustration 3

Assume this time that Jerry, who normally has a 31 December year end, made up his cessation accounts for the 18 months ended 30 June 2010. These accounts show a profit of £35,000.

Again the year of cessation is 2010/11 as the cessation was on 30 June 2010. The penultimate year of assessment is 2009/10, and the basis of assessment is CYB to the normal accounting date. As Jerry has a 31 December year end, this will be the year ended 31 December 2009 which gives us a profit as follows.

Penultimate Year:

2009/10

CYB y/e 31.12.09 = $\frac{12}{18} \times$ £35,000 £23,333

The final year of assessment is 2010/11. The basis period will run from the day after the end of the previous period to the date of cessation.

Final Year:

2010/11	£
1.1.10 – 30.6.10 = $\frac{6}{18} \times$ £35,000	11,667
Less: overlap profit (assumed)	(6,000)
Taxable trading profits 2010/11	£5,667

Illustration 4

Finally, let's consider Ronke who normally makes up accounts to 30 September each year. She ceased trading on 31 January 2011. Her accounts, as adjusted for tax purposes, showed the following profits:

	£
y/e 30.9.09	53,000
y/e 30.9.10	42,000
4 m/e 31.1.11	12,000

Ronke has unrelieved overlap profits of £8,000 from the commencement of trade.

Ronke ceases trading on 31 January 2011, which means the tax year of cessation is 2010/11. Therefore the penultimate year of assessment is 2009/10.

Penultimate Year:

2009/10

CYB	y/e 30.9.09	£53,000

The final tax year is 2010/11. The basis period is the day after the end of the previous period to the date of cessation which is from 1 October 2009 to 31 January 2011.

This means that the tax adjusted profits of two accounting periods will be assessed in 2010/11 because they both ended in the final tax year of trade.

Final Year:

2010/11

	£
y/e 30.9.10	42,000
4 m/e 31.1.11	12,000
Less: overlap profit	(8,000)
Taxable trading profits 2010/11	£46,000

Answer 1

	Overlap period
a) 31 January year end	**2** months
b) 30 April year end	**11** months

Answer 2

a)	First tax year of trading?	**2008/09**
b)	Basis period for first tax year?	**1.1.09 – 5.4.09**
c)	Profit earned in that period?	$\frac{3}{7}$ x £14,000 = **£6,000**
d)	Accounting period ending in the second tax year ?	**Yes**
	If so, how long it is?	**7 months** long
e)	Basis period for second tax year?	First 12 months **1.1.09 – 31.12.09**
f)	Profit earned in that period?	£14,000 + $\frac{5}{12}$ x £18,000 = **£21,500**
g)	Basis period for third tax year?	CYB **y/e 31.7.10**
	Profit earned in that period?	**£18,000**
h)	Months of overlap expected?	31 July to 5 April = **8 months**

Answer 3

a) First tax year of trading? **2009/10**

b) Basis period for first tax year? **1.2.10-5.4.10**

Profit earned in that period? $\frac{2}{16}$ x £40,000 = **£5,000**

c) Accounting period ending in the second tax year? **No**

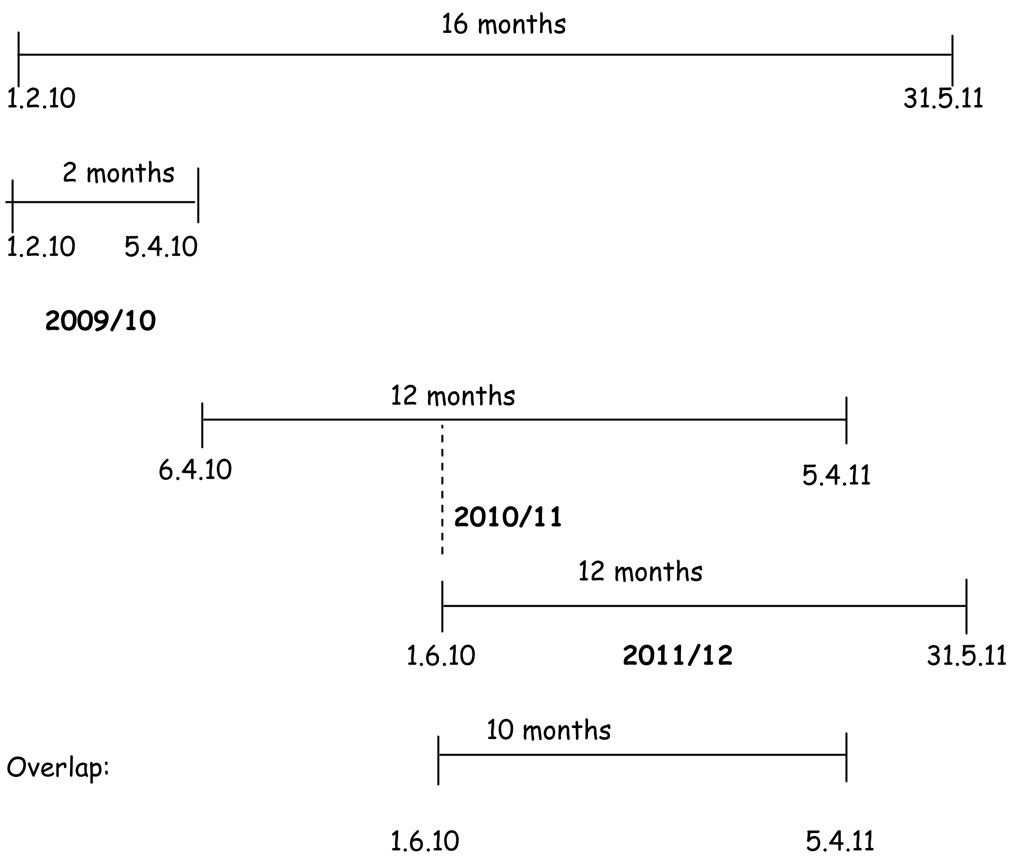
d) Basis period for second tax year? **6.4.10 – 5.4.11**

Profit earned in that period? $\frac{12}{16}$ x £40,000 = **£30,000**

e) Basis period for third tax year? **1.6.10 – 31.5.11**

Profit earned in that period? $\frac{12}{16}$ x £40,000 = **£30,000**

f) Months of overlap expected? 31 May – 5 April = **10 months**



Overlap period;

10 months (1.6.10 – 5.4.11) = $\frac{10}{16}$ x £40,000 = **£25,000**

Answer 4

The basis period for 1997/98 is y/e 30.4.97

The transitional overlap period is the 11 months from 1.5.96 to 5.4.97

The transitional overlap profits are $\frac{11}{12}$ x £36,000 = **£33,000**

