CHAPTER 7

CHANGE OF ACCOUNTING DATE

Statutory references are to ITTOIA 2005 unless stated otherwise

7.1 Introduction

Special rules apply to calculate a trader's taxable profits when he changes his accounting date. These special rules apply for **unincorporated businesses only** – i.e. they apply for sole traders and partnerships, but **they do not apply for companies**.

A trader will change his accounting date when he draws accounts for a **period which is not 12 months long**. In this case, the current year basis cannot apply in the usual way, so special rules are required to determine the taxable trading profits.

The change of accounting date rules will not apply in the year the trader commences or the year in which the trade ceases – in these instances, the opening and closing year rules will apply.

Finally, when considering the change of accounts date rules, remember two basic principles:

1) The basis period will never be less than 12 months long; and
2) HMRC will always tax all profits – there will never be a period when profits are earned but are not taxed.

7.2 The 4-stage process

To calculate trading profits on a change of accounting date, we follow a 4-stage process as outlined below:

1) Identify the "year of change".

2) Calculate taxable profits for all tax years either side of the year of change:

   - Before the change - tax 12 months of profits up to the "old" accounts date.

   - After the change - tax 12 months of profits up to the "new" accounts date.

3) Identify the "gap" period – the "gap" here is the period of profits which have not thus far been taxed.

4) Tax the profits in the "gap":

- If the "gap" exceeds 12 months, reduce the profits by **using up** an appropriate amount of **overlap relief**.

- If the "gap" is less than 12 months, tax an appropriate amount of profits from the previous period to make the gap up to the 12 months. This will **create additional overlap relief**.

On a change of accounting date, you will either be **using overlap relief or creating additional overlap relief**.

If you follow this process, you should always get the correct taxable profits in the correct tax years.

7.3 The year of change

ITTOIA 2005, s. 214

The year of change is the earlier of:

(i) the first tax year in which accounts are **not drawn to the old date**; or

(ii) the first tax year in which accounts **are drawn to the new date**.

Illustration 1

Assume a trader prepares accounts to 30 April 2010. In the next accounting period he changed his accounting date to 31 March 2011. We work out the year of change as follows:

(i) Using the "old" date, the first time accounts are not drawn up to 30 April is the period to 30 April 2011. That falls into **2011/12**.

(ii) The first time accounts are drawn up to the "new" date is 31 March 2011. That falls into **2010/11**.

The earlier of the two years is 2010/11 and this year is therefore **the year of change**.

Example 1

A trader prepares accounts to 31 December 2008. In the next accounting period, he changed his accounting date by drawing accounts for the 18 months to 30 June 2010.

Determine the year of change.

7.4 Practice examples

Illustration 2

John, a sole trader, has a 30 September year-end. Profits are as follows:

y/e 30.9.09	£120,000
y/e 30.9.10	£240,000

John changes his accounting date to 31 January 2011 by drawing up a set of accounts for 4 months.

4 m/e 31.1.11	£80,000
y/e 31.1.12	£300,000

John has 6 months of overlap profits brought forward totalling £90,000.

We will calculate John's profits for all years by following the 4-stage process.

1. Identify the year of change

   Using the old date, the first year accounts are not made up to 30 September is the period to 30 September 2011. This falls into the tax year 2011/12.

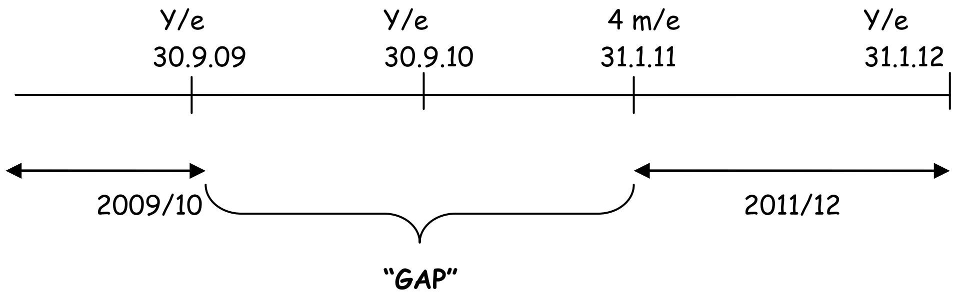
   The first time accounts are drawn to the new date of 31 January is for the period ended 31 January 2011. This falls in the tax year 2010/11.

   The **earlier of the two years is 2010/11**, therefore this is the year of change.

2. Calculate profits either side of the year of change.

2009/10	12 m/e 30.9.09 (12 months up to the old date)	£120,000
2010/11	"Year of change"	?
2011/12	12 m/e 31.1.12 (12 months up to the new date)	£300,000

3. Identify the "gap" period.



The period of profits which has so far not been taxed is **16 months** from **1 October 2009 to 31 January 2011**.

Profits in this 16-month period are £(240,000 + 80,000) = £320,000.

4. Tax the profits in the "gap"

As the "gap" is more than 12 months, we tax all profits then reduce down to 12 months by using up 4 months of the overlap profits;

2010/11;	£
Year of change	
1 October 2009 – 31 January 2011 (16 months)	
£(240,000 + 80,000)	320,000
Less: overlap profits relieved (4 months)	
$\frac{4}{6}$ x £90,000	(60,000)
Trading Income (12 months)	260,000

Overlap profits	
B/f (6 months)	90,000
Relieved in 2010/11 (4 months)	(60,000)
C/f (2 months)	£30,000

Summary of profits:

2009/10	12 m/e 30.9.09	£120,000
2010/11	"Year of change" (1.10.09 – 31.1.11)	£260,000
2011/12	12 m/e 31.1.12	£300,000

Note here that John has moved his accounts date 4 months closer to 5 April (ie, from 30 September to 31 January). HMRC will therefore give him relief for 4 months of his overlap profits.

Illustration 3

Andy, a sole trader, has a year end of 31 December. Profits are as follows:

y/e 31.12.08	£40,000
y/e 31.12.09	£48,000

Andy changes his accounting date to 30 June. Profits are as follows:

6 m/e 30.6.10	£30,000
y/e 30.6.11	£70,000

Andy has overlap profits brought forward of £5,000, representing 3 months.

We will calculate Andy's profits for all years by following the 4-stage process.

1. Identify the year of change

   Using the old date, the first year accounts are not made up to 31 December is the period to 31 December 2010. This falls into the tax year 2010/11.

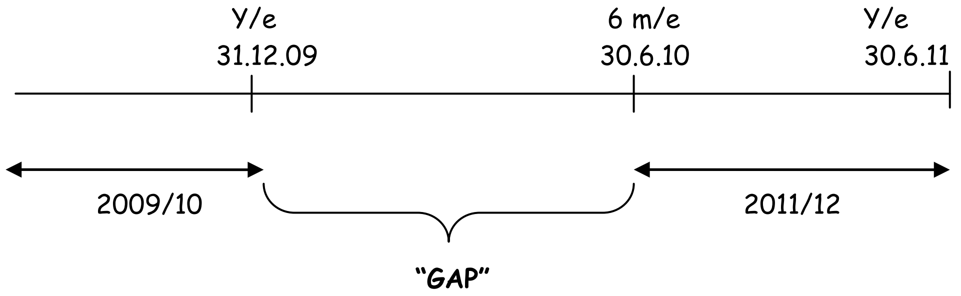
   The first time accounts are drawn to the new date of 30 June is for the period ended 30 June 2010. This again falls in the tax year 2010/11.

   2010/11 is therefore the year of change.

2. Calculate profits either side of the year of change.

2009/10	12 m/e 31.12.09 (12 months up to the old date)	£48,000
2010/11	"Year of change"	?
2011/12	12 m/e 30.6.11 (12 months up to the new date)	£70,000

3. Identify the "gap" period.



The period of profits which has so far not been taxed is **6 months** from **1 January 2010 to 30 June 2010**.

Profits in this 6-month period are £30,000.

4. Tax the profits in the "gap"

As the "gap" is less than 12 months, we tax all profits then increase this to 12 months by taxing an appropriate amount of profits from the preceding period:

2010/11	£
Year of change	
1.1.10 – 30.6.10 (6 months)	30,000
Add: another 6 months from previous period	
1.7.09 – 31.12.09	
(6/12 x £48,000)	24,000
Trading Income (12 months)	54,000
Overlap profits	
B/f (3 months)	5,000
Add: created on change of accounts date (6 months)	24,000
C/f (9 months)	29,000

Summary of profits:

2009/10	12 m/e 31.12.09	£48,000
2010/11	"Year of change" (1.7.09 – 30.6.10)	£54,000
2011/12	12 m/e 30.6.11	£70,000

Note here that Andy has moved his accounts date 6 months further away from 5 April (i.e. from 31 December to 30 June). HMRC will therefore double-tax Andy on 6 months of profits thereby creating another 6 months of overlap relief.

Illustration 4

Sanjay, a sole trader, has a year-end of 31 December. He changed his accounts date by drawing accounts for the **15 months** to **31 March 2010.** Profits are as follows:

	£
y/e 31.12.08	100,000
15 m/e 31.3.10	150,000
y/e 31.3.11	130,000

Sanjay has overlap profits brought forward of £30,000, representing 3 months.

We will calculate Sanjay's profits for all years by following the 4-stage process.

1. Identify the year of change

   Using the old date, the first year accounts are not made up to 31 December is the period to 31 December 2009. This falls into the tax year 2009/10.

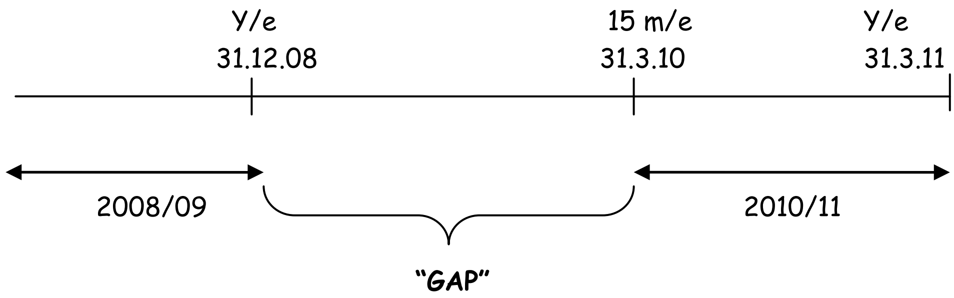
   The first time accounts are drawn to the new date of 31 March is for the period ended 31 March 2010. This again falls in the tax year 2009/10.

   2009/10 is therefore the year of change.

2. Calculate profits either side of the year of change.

2008/09	12 m/e 31.12.08 (12 months up to the old date)	£100,000
2009/10	"Year of change"	?
2010/11	12 m/e 31.3.11 (12 months up to the new date)	£130,000

3. Identify the "gap" period.



   The period of profits which has so far not been taxed is **15 months** from **1 January 2009 to 31 March 2010**.

   Profits in this 15-month period are £150,000.

4. Tax the profits in the "gap"

As the "gap" is more than 12 months, we tax all profits then reduce down to 12 months by using up 3 months of the overlap profits;

2009/10;	£
Year of change	
1.1.09 – 31.3.10 (15 months)	150,000
Less: overlap profits relieved (3 months)	
$\frac{3}{3}$ x £30,000	(30,000)
Trading Income (12 months)	120,000

Overlap profits	
B/f (3 months)	30,000
Relieved in 2009/10 (3 months)	(30,000)
C/f	£NIL

Summary of profits:

2008/09	12 m/e 31.12.08	£100,000
2009/10	"Year of change" (1.1.09 – 31.3.10)	£120,000
2010/11	12 m/e 31.3.11	£130,000

Note here that Sanjay has moved his accounts date 3 months closer to 5 April (i.e. from 31 December to 31 March). HMRC will therefore give him relief for 3 months of his overlap profits. As Sanjay now has a 31 March year end, he will have no overlap profits available to use.

Illustration 5

Douglas draws accounts for the year to 31 December 2008. He then changed his accounts date by drawing a set of accounts for the 17 months to 31 May 2010. His profits are as follows:

	£
y/e 31.12.08	60,000
17 m/e 31.5.10	102,000
y/e 31.5.11	85,000

Douglas has overlap profits brought forward of £24,000, representing 3 months.

We will calculate Douglas's profits for all years by following the 4-stage process.

1. Identify the year of change

Using the old date, the first year accounts are not made up to 31 December is the period to 31 December 2009. This falls into the tax year 2009/10.

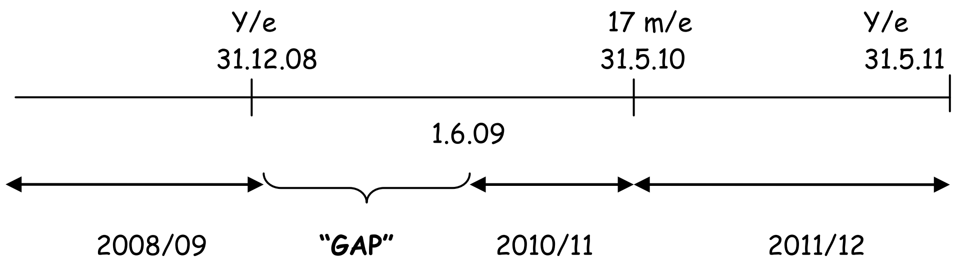
The first time accounts are drawn to the new date of 31 May is for the period ended 31 May 2010. This falls into the tax year 2010/11.

The earlier of the years is 2009/10, so **2009/10** is therefore the year of change.

2. Calculate profits either side of the year of change.

2008/09	12 m/e 31.12.08 (12 months up to the old date)	£60,000
2009/10	"Year of change"	?
2010/11	12 m/e 31.5.10 (12 months up to the new date) 12/17 x £102,000	£72,000
2011/12	12 m/e 31.5.11 (12 months up to the new date)	£85,000

3. Identify the "gap" period.



The period of profits which has so far not been taxed is **5 months** from **1 January 2009 to 31 May 2009**.

Profits in this 5-month period are

5/17 x £102,000 = £30,000.

4. Tax the profits in the "gap"

As the "gap" is less than 12 months, we tax all profits then increase this to 12 months by taxing an appropriate amount of profits from the preceding period:

2009/10	£
Year of change	
1.1.09 – 31.5.09 (5 months)	30,000
Add: another 7 months from previous period	
1.6.08 – 31.12.08	
(7/12 x £60,000)	35,000
Trading Income (12 months)	65,000

Overlap profits	
B/f (3 months)	24,000
Add: created on change of accounts date (7 months)	35,000
C/f (10 months)	59,000

Summary of profits:

2008/09	12 m/e 31.12.08	£60,000
2009/10	"Year of change" (1.6.08 – 31.5.09)	£65,000
2010/11	12 m/e 31.5.10	£72,000
2011/12	12 m/e 31.5.11	£85,000

Note here that Douglas has moved his accounts date 7 months further away from 5 April (i.e. from 31 December to 31 May). HMRC will therefore double-tax Douglas on 7 months of profits thereby creating another 7 months of overlap relief.

7.5 Conditions for a valid change of accounting date

The rules in this chapter will only apply where:

1) the **accounting period of change does not exceed 18 months;** and ITTOIA 2005 s. 217

2) the taxpayer **informs HMRC of the change by 31 January following the year of change;** and

3) there has been **no other change in the previous 5 tax years or the current change of date is for a bona fide commercial reason.**

If a business changes its accounting date and breaches one of these conditions, HMRC will not recognise the change.

For example, if a business changes its accounting date and the accounting period of change was 19 months, HMRC will require a computation up to the old 12 month date – they will not recognise the new date. Consequently a trader must satisfy **all** conditions before he can apply the above rules.

Example 2

George prepares accounts to 31 July every year. George decides to change his accounting date to 31 December. He has 8 months overlap profits brought forward of £32,000.

George's profits were as follows:

	£
Year to 31 July 2009	80,000
Year to 31 July 2010	90,000
Five months to 31 December 2010	60,000
Year to 31 December 2011	100,000

Calculate the assessable profits for 2009/10, 2010/11 and 2011/12.

Example 3

Ted prepares accounts to 31 August every year. He decides to change his accounting date to 30 June. He has overlap profits brought forward of £14,000 which represents 7 months.

Ted's profits were as follows:

	£
Year to 31 August 2008	36,000
10 months to 30 June 2009	38,000
Year to 30 June 2010	42,000

Calculate the assessable profits for 2008/09, 2009/10 and 2010/11 together with the overlap relief carried forward.

Answer 1

Using the "old" date, the first time accounts are not drawn up to 31 December is the period to 31 December 2009. That falls into **2009/10**.

The first time accounts are drawn up to the "new" date is 30 June 2010. That falls into **2010/11**.

The year of change is the earlier tax year, **the year of change** is therefore **2009/10**.

Answer 2

1. Year of change.

   The "old" date was 31 July. Therefore George would have had accounts to the year ended 31 July 2011 had he not changed his accounting date. The year ended 31 July 2011 ends in the tax year 2011/12.

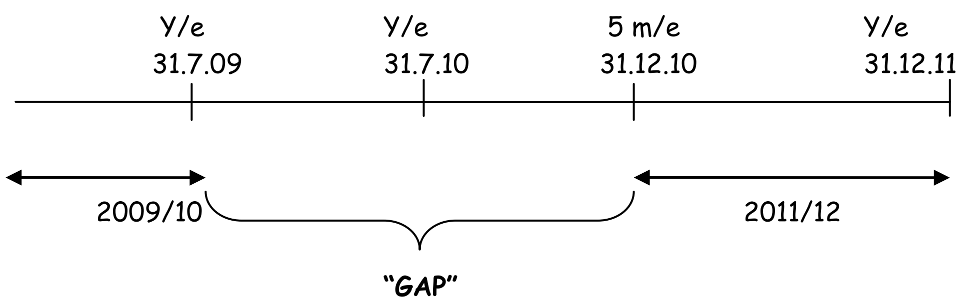
   His first "new" date is 31 December 2010. The period ended 31 December 2010 ends in the tax year 2010/11.

   The **earlier** of these two years is 2010/11. Therefore 2010/11 is the year of change.

2. Calculate profits either side of the year of change.

2009/10	12 m/e 31.7.09 (12 months up to the old date)	£80,000
2010/11	"Year of change"	?
2011/12	12 m/e 31.12.11 (12 months up to the new date)	£100,000

3. Identify the "gap" period.



The period of profits which has so far not been taxed is **17 months** from **1 August 2009 to 31 December 2010**.

Profits in this 17-month period are £(90,000 + 60,000) = £150,000.

4. <u>Tax the profits in the "gap"</u>

As the "gap" is more than 12 months, we tax all profits then reduce down to 12 months by using up 5 months of the overlap profits:

2010/11	£
Year of change	
1.8.09 – 31.12.10 (17 months)	150,000
Less: overlap profits relieved (5 months)	
$\frac{5}{8} \times £32,000$	(20,000)
Trading Income (12 months)	130,000
Overlap profits	
B/f (8 months)	32,000
Relieved in 2010/11 (5 months)	(20,000)
C/f (3 months)	£12,000

Summary of profits:

2009/10	12 m/e 31.7.09	£80,000
2010/11	"Year of change" (1.8.09 – 31.12.10)	£130,000
2011/12	12 m/e 31.12.11	£100,000

Answer 3

1. Year of change.

Using the old date, the first year accounts are not made up to 31 August is the period to 31 August 2009. This falls into the tax year 2009/10.

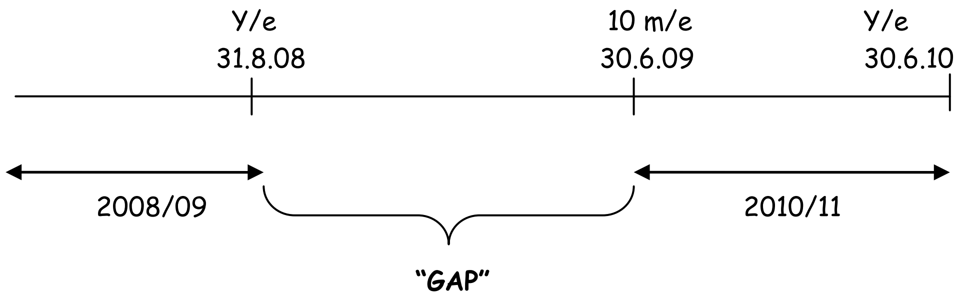
The first time accounts are drawn to the new date of 30 June is for the period ended 30 June 2009. This again falls in the tax year 2009/10.

2009/10 is therefore the year of change.

2. Calculate profits either side of the year of change.

2008/09	12 m/e 31.8.08 (12 months up to the old date)	£36,000
2009/10	"Year of change"	?
2010/11	12 m/e 30.6.10 (12 months up to the new date)	£42,000

3. Identify the "gap" period.



The period of profits which has so far not been taxed is **10 months** from **1 September 2008 to 30 June 2009**.

Profits in this 10-month period are £38,000.

4. Tax the profits in the "gap"

As the "gap" is less than 12 months, we tax all profits then increase this to 12 months by taxing an appropriate amount of profits from the preceding period:

	£
2009/10	
Year of change	
1.9.08 – 30.6.09 (10 months)	38,000
Add: another 2 months from previous period	
1.7.08 – 31.8.08	
(2/12 x £36,000)	6,000
Trading Income (12 months)	44,000
Overlap profits	
B/f (7 months)	14,000
Add: created on change of accounts date (2 months)	6,000
C/f (9 months)	20,000

Summary of profits:

2008/09	12 m/e 31.8.08	£36,000
2009/10	"Year of change" (1.7.08 – 30.6.09)	£44,000
2010/11	12 m/e 30.6.10	£42,000