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CHARTERED ACCOUNTANTS

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Buzzacott's Professional Practices Group

Summer 2018 Newsletter

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CHOOSING A PARTNERSHIP YEAR END THAT WORKS FOR YOUR BUSINESS

Choosing a year end for your partnership may not always sound like the hardest decision to make in business, yet it is one that can have a profound effect on the tax profile of the partners.

It is not uncommon for partnerships to choose a 31 March year end. This ensures that it aligns with the UK tax year which from an administrative stand point, makes it very simple. A 31 March year end avoids complex opening year rules when new partners join the firm and on an ongoing basis partners pay tax on profits arising in any given financial year by the following 31 January.

However, many partnerships choose not to align their financial year end to that of the tax year and there are a number of reasons why this can make a significant difference for the partners.

DELAYING TAX PAYMENTS

When a partner joins a partnership with a non-coterminous year end (i.e. not 31 March), a complex process of aligning the partnership year end with the UK tax year must be undertaken in order for the partner to file his personal tax return. These rules will result in the same income being subject to tax twice initially.

While this may sound less favourable for the individual, it can actually result in better cash flow and tax payment management opportunities on an ongoing basis. It is best represented by an example:

If a partnership has a year end of 31 March 2018, the profits from this year will be reported on the tax return to 5 April 2018, with the individual partners liable to tax on their share by 31 January 2019.

Compare this with a partnership that has a 30 April year end. The profits from a partnership with a year end of 30 April 2018 will be reported on the individual's tax returns for the year ended 5 April 2019. The tax on these profits won't become payable until 31 January 2020. This allows partners far more time to budget for future tax bills where profit is increasing. Of course, these partners will still have tax payments due on 31 January 2019 but these payments will be based on profits earned in the partnership during the year ended 30 April 2017.

DELAYING FILING REQUIREMENTS

While a 31 March year end may be simpler from an administrative standpoint, a non-coterminous year end offers something equally valuable – time.

The process of preparing a set of final, and in some cases audited, accounts along with a tax computation can be lengthy. With a 31 March year end, this must all take place before 31 January of the following year at which point partners are required to file their personal tax returns. On paper this sounds like ample time but in reality, the day to day pressures of business often mean this time flies by. It is not uncommon for partnerships with 31 March year ends to file their partnership tax returns late in January.

...A NON-COTERMINOUS YEAR END MAY NOT SUIT EVERY PARTNERSHIP'S NEEDS, HOWEVER THERE CAN BE SIGNIFICANT BENEFITS OF HAVING ONE...

Contrast this with a non-coterminous year end, a partnership with a 30 April 2018 year end does not need to file its partnership tax return for that year until 31 January 2020. Of course the partnership, if it is an LLP will have requirements to file accounts which may mean that accounts are still produced as efficiently, however the result is that partnerships with non-coterminous year ends often file very early in the tax year. This again ensures that the partnership and its partners have the maximum visibility of upcoming tax liabilities.

A non-coterminous year end may not suit every partnership's needs, however there can be significant benefits of having one. If you would like to understand the pros and cons further or alternatively would like to discuss potentially changing your existing year end, we would be happy to talk through this with you.

MAKING TAX DIGITAL FOR VAT

From 1 April 2019, nearly all VAT registered UK established businesses, with a taxable turnover above the VAT registration threshold (£85,000), will need to comply with Making Tax Digital (MTD) for VAT. Businesses have been anxiously awaiting the draft legislation to see what will be required of them and what they will need to do to be compliant.

MTD for VAT involves two key concepts:

1. Keeping records digitally; and

2. Digital submission of the VAT return via functional third party compatible software.

HMRC has stated that one aim of MTD is to reduce the VAT lost through errors and mistakes arising from manual input.

WHAT ARE THE CHALLENGES?

HMRC says it will ensure that there is software and support in place that meets the needs of the businesses affected by the changes and that it is testing the processes extensively. It should be noted HMRC have no plans to provide software, as it does presently, and will rely on third party software providers to develop the relevant software.

...ONE OF THE SIGNIFICANT ISSUES WITH MTD FOR VAT IS THE IMPLEMENTATION DATE OF APRIL 2019.

In the first year (from 1 April 2019), HMRC anticipates a lenient approach to provide businesses extra time to make legacy systems compatible.

One of the significant issues with MTD for VAT is the implementation date of April 2019. This date clashes with the anticipated date of Brexit which, depending on the outcome of negotiations between the UK and EU, could require its own changes for VAT at the same time. Therefore, businesses which trade cross border could face the task of dealing with the effects of MTD and Brexit at the same time.

With less than a year to go, the full picture of the changes MTD and Brexit will bring is not yet fully confirmed, giving VAT registered businesses very little time to identify and make the necessary adjustments.

We have already seen changes to the timeframe with the introduction of MTD from HMRC and there is still time between now and 1 April next year for further changes.

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SUN, SEA AND A SUMMER TAX BILL?

As the end of July rapidly approaches, some taxpayers are faced with the recurring prospect of yet another tax payment becoming due. The UK's tax payment system is unfortunately arranged so that payments of tax for the self-employed fall at the most inconvenient times, be it following the busy and always expensive Christmas period (31 January) or before your annual summer holiday (31 July).

However, there may be something you can do to ease your cash flow planning.

If your income for the 2017/18 tax year is lower than that of the previous year, there may be an opportunity to reduce the amount of tax payable on 31 July. By completing your tax return before this date, it is possible to review your tax position and, where possible, adjust the amount you pay to HMRC. For those whose income has increased, unfortunately there may be no scope to reduce the amount you have to pay.

The 31 January tax payment is made up of a balancing tax payment for the tax year plus a payment on account for the following tax year, making it possibly the largest payment of tax you will make in any given year where your income has increased. Completing your tax return early ensures you can fully benefit from tax advice as soon as possible. The last thing anyone wants to receive is an unexpected, large tax bill.

ENTREPRENEURS' RELIEF: EXTENSION TO QUALIFYING CONDITIONS?

The government has launched a consultation to review how individuals who own at least 5% of the shares in a trading company can retain entrepreneurs' relief after the shareholding falls below the 5% threshold in certain circumstances.

As we have seen in the past few years, the government is keen to stimulate growth in the economy and is considering various options on how this can be achieved. In this instance, the proposal is for the relief to remain available on gains accrued up to the date the new shares are issued as a result of raising funds for commercial purposes. The intention is to incentivise entrepreneurs to remain involved in their businesses after receiving external investment.

The current proposal seems a sensible measure to allow entrepreneurs' relief to be retained for qualifying individuals after a company raises external investment. It is also a practical measure to support business growth as it encourages entrepreneurs to remain involved. It should hopefully end the dilemma between an increased personal tax cost and limiting growth of a business due to concerns around raising external finance.

Entrepreneurs' relief potentially offers a very attractive tax relief, however, it is a complex area of tax legislation and the qualifying conditions need to be carefully scrutinised. If further changes are to be introduced, the complexity will only increase and entrepreneurs should therefore seek advice at an early stage when considering a transaction and how their personal tax position is implicated, as well as that of the company.

The consultation is underway with the intention of introducing any new legislation with effect from April 2019.

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About us

Buzzacott's Professional Practices team are specialists with years of experience in working with small to mid-tier businesses, advising partners in firms of solicitors, patent attorneys, architects, chartered surveyors, chartered accountants and other sectors.

We know what it takes to start a practice and make it grow. We understand the business and tax needs and the burden of compliance. And we can inform the difficult decisions that come with change: when and how to finance, strategies for tax, the pros and cons of LTD/LLP conversion, succession planning – and the crucial task of managing growth in good times and preserving stability in bad.

We build long and close working relationships with our clients, who come to us for our understanding of the issues professional practices face but stay with us because our empathy with their business brings savings in time and risk.

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