

How to calculate your taxable profits

i **Contacts**

Please phone:

- the number printed on page TR 1 of your tax return
- the SA Helpline on **0845 9000 444**
- the SA Orderline on **0845 9000 404** for helpsheets

or go to

www.hmrc.gov.uk

This helpsheet gives you information to help you fill in boxes in:

- the *Self-employment* pages of your personal tax return, or
- the *Trading* pages of the Partnership Tax Return and the *Partnership* pages of your personal tax return.

This helpsheet explains:

- accounting periods
- how business profits are taxed
- cost of sales
- allowable business expenses
- basis periods
- overlap profits and relief
- capital allowances and balancing charges
- commencements and cessations
- losses – terminal loss relief
- partners' trading or professional profits
- provision of personal services through a partnership.

More detailed information is available if you need it. This helpsheet also refers you to other sources of information.

If you do not have accounts prepared for your business, you should read:

- 'accounting period' to mean the period for which you provide details of your business income and expenditure, and
- 'accounting date' to mean the date on which that period ends.

Accounting periods – boxes 3.4 and 3.5 of the Partnership Tax Return or boxes 8 and 9 of the *Self-employment (full)* pages

You will need to decide upon your accounting date – that is, the date to which your accounts are drawn up. Enter the first day covered by the accounts in box 3.4 (or 8) and your accounting date in box 3.5 (or 9).

You can choose any convenient date, for example, the anniversary of the date you began your business or, in a seasonal business, a date when trade is slack and stocks are low. You are entitled to change to a different date if you want to. However, whatever date you choose, you will find your tax is easier to work out if you keep to it each year.

And if you have just started in business, you may find 5 April is the best date to choose as it keeps your tax calculation simple.

Even if you do not have accounts prepared for your business every year, your taxable profit should still be worked out using generally accepted accounting practices. The *Self-employment notes* and the following notes provide some practical advice on how to complete your tax return if you do not have accounts.

How business profits are taxed

Profits which arise from carrying on trades, professions and vocations cannot usually be worked out by simply adding together the cash receipts of the business and deducting expenses paid out. This would show the business' cash flow, but it would not usually be a proper measure of its profits.

To arrive at the profits it is necessary to draw up accounts using the methods which accountants have developed for dealing with income that has been earned but not received, expenses which have been incurred but not paid or paid but not fully used, and so on. And the profits arrived at using these methods (the commercial profits) have to be adjusted for tax purposes. This is because in arriving at the commercial profits some items of income or expense may be recognised as not taxable or tax deductible, and other special allowances may reduce the amount of profits which are taxable.

These guidance notes explain these practices as fully as possible, but they are not a comprehensive guide for all circumstances. If you are unsure about the correct treatment of a particular item you should ask us or your tax adviser.

Cost of sales – box 3.46 of the Partnership Tax Return or box 16, *Cost of goods bought for resale or goods used, of the Self-employment (full) page*

This is the cost of raw materials and goods bought for resale which you used during this accounting period. Make sure you count creditors, that is items delivered to you but which you had not paid for at the end of the period. Do not count items you paid for in this period if they were included as creditors in your last accounts.

You should include the value of stock you had on hand and uncompleted work in progress at the start of the period (this must be the closing figure which you used in your last accounts), but exclude the value of stock and work in progress at the end.

Value your stocks for resale and your work in progress at their cost to you or, if this happens to be lower, at the net price they will fetch when sold in the normal course of your business. Value consumable stores at their cost to you, or if they have deteriorated or become obsolete, at their net realisable value where this is lower. The Working Sheet below will help you decide how much you can claim.

Working Sheet

Goods and raw materials you bought this period

A £

Stock on hand and work in progress at the start of this period

B £

Box A plus box B

C £

Stock on hand and work in progress at the end of this period

D £

Box C minus box D

E £

Copy the amount in box E to box 3.46 of the Partnership Tax Return or box 16 of the *Self-employment (full) page*, SEF 2.

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Allowable business expenses

Broadly speaking, you can deduct from your turnover all the costs you incur for the sole purpose of earning business profits. But you cannot deduct costs which you incur for a non-business purpose, such as your own personal expenses or drawings. And you cannot deduct capital costs, that is, the cost of buying fixed assets or intangibles, such as goodwill, which last for several years (or losses you suffer when you sell them). But you may be able to claim capital allowances (see page 8) for these capital costs. Additionally, you cannot deduct costs which are recoverable under an insurance policy.

Business expenditure is allowed in your accounts for a period if it was incurred in earning turnover in that period, even if you are not due to pay the money until later.

The amount to deduct is the amount of the expense which was used up during this period. This may not be the amount actually paid. For example, if you owe money at the end of the account – your trade creditors – it may be that this should be included in this account rather than later when it is paid. (Make sure you do not deduct any payments made in this account which you included as trade creditors in your last accounts.) But if you make a payment which is used up over two periods or more you should spread it in your accounts. For example, if halfway through the year you pay 12 months rent in advance for your business premises, only one half of the payment should be deducted this year and the other half next year.

The *Self-employment (full) notes* tell you where to include your expenses. There are tables on page SEFN 8 to help you to decide which expenses can or cannot be claimed in working out business profits for tax purposes.

Use of mileage rates to calculate motor expenses

You may calculate your motor expenses using a fixed rate for each business mile, provided that:

- the rate used does not exceed the appropriate Approved Mileage Allowance Payments (AMAPs) rate for the vehicle at the time it is used. We publish these rates annually
- the annual turnover of the business at the time the vehicle is acquired does not exceed the VAT registration threshold (currently £73,000), and
- no other motoring expenses (other than interest on a loan used to purchase the vehicle) are claimed and no capital allowances are claimed on the vehicle (since AMAPs rates already contain an element to allow for depreciation), and
- such a basis is applied consistently from year to year so that any change to or from an ‘actual’ basis (including one required by a change in turnover relative to the VAT registration threshold) takes place only when one vehicle is replaced by another.

The VAT registration threshold is used here purely as a convenient limit whose real value is regularly reviewed; this practice has no application to VAT accounting and does not affect existing VAT rules and practices.

This practice applies to cars, vans, motorcycles and bicycles. The AMAPs mileage rates vary between vehicles.

The amounts to use are:

- car or van 45 pence a mile for the first 10,000 miles
25 pence a mile thereafter
- motorcycle 24 pence a mile
- cycle 20 pence a mile.

If you have existing arrangements for the use of mileage rates other than those set out in this helpsheet, we will expect that on the next change of vehicle, these arrangements are replaced either by claims to actual expenses or (where the conditions in this helpsheet are satisfied) by claims in accordance with the practice set out in this helpsheet.

Whatever your business and however you work out your motoring expenses, you must keep adequate records to back up your tax return. If you need more information please go to www.hmrc.gov.uk or phone the SA Helpline on 0845 9000 444.

Your basis period for 2011–12

You pay tax for 2011–12 according to the profits or losses for your basis period. After the first year or two in business, your basis period will be the 12-month period you use for your accounts, except if you change your accounting date. However, you should check the following rules which enable you to work out your basis period. (Partnerships do not have basis periods. But the rules for changes of accounting dates apply. For information about partners' own basis periods, see page 11.)

Your accounting period is the period your accounts cover and your accounting date is the last day of your accounts. For example, if you draw up accounts each year to 31 December, your accounting period for the 2011–12 tax year is the 12-month period 1 January 2011 to 31 December 2011 and your accounting date is 31 December 2011.

General rules for businesses started in 2009–10 or earlier

If you started in business before 6 April 2010 and you were still in business at 5 April 2012 your basis period is the 12 months to your accounting date in 2011–12, unless you have changed accounting date during 2011–12 (see 'Changes of basis period' on page 6).

Example 1

You started your business on 1 January 2010 and have drawn up accounts to 31 December 2010 and 31 December 2011. Your basis period for 2011–12 is the 12 months 1 January 2011 to 31 December 2011.

Commencement

Business started in 2010–11

If you started in business during the period 6 April 2010 to 5 April 2011, your basis period is one of the following, unless you have changed accounting date during 2011–12 (see 'Changes of basis period' on page 6).

If your accounting date in 2011–12 is 12 months or more after the date on which you started in business, your basis period is the 12 months to your accounting date.

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If your accounting date in 2011–12 is less than 12 months after the date on which you started in business, your basis period is the 12 months beginning on the date you started.

If you do not have an accounting date in 2011–12, your basis period is the 12-month period 6 April 2011 to 5 April 2012.

Example 2

You started in business on 1 January 2011.

- If your accounting date is 31 March 2012, your basis period is 1 April 2011 to 31 March 2012.
- If your accounting date is 31 October 2011, your basis period is 1 January 2011 to 31 December 2011.
- If your first accounting date is not until 30 April 2012, your basis period is 6 April 2011 to 5 April 2012.
- If you drew up an account to 31 March 2011 but did not draw up an account to 31 March 2012, see 'Changes of basis period' on page 6).

Business started in 2011–12

If you started in business during the period 6 April 2011 to 5 April 2012, your basis period is the period from the date you started to 5 April 2012.

Example 3

You started in business on 1 July 2011. Your basis period is 1 July 2011 to 5 April 2012.

Cessations

If you ceased in business during the period 6 April 2011 to 5 April 2012, your basis period is the period between the end of the basis period for 2010–11 and the date on which your business ceased.

Example 4

Your business ceased to trade on 31 December 2011. Your 2010–11 basis period ended on 30 April 2010. Your basis period is the 20-month period 1 May 2010 to 31 December 2011.

Changes of accounting date

There is a change of accounting date if:

- you have drawn up your accounts to a date which is not the same as the date used for tax purposes last year, or
- you intend to draw up accounts for more than 12 months and no accounting date falls in the 2011–12 tax year, or
- you changed your accounting date last year, this was not accepted by us, and you have drawn up your accounts to the same date this year. (But if you have changed back to your old date this is not treated as a change of accounting date.)

You will usually want your new accounting date to count for tax, otherwise your basis period will not end on the same date as your accounts. However, if you intend this to be only a temporary change, you may want to ignore it for tax purposes. You can then work out your tax using the same basis period as last year.

Changes of basis period – special rules which apply if you change your accounting date

The notes above explain when a change of accounting date takes place for tax purposes. If you are in any doubt whether your accounting date has changed according to these rules, you should contact us or your tax adviser for help.

When you change accounting date and you want it to count for tax purposes, your basis period will be given by one of two rules:

- If your accounting date in 2011–12 is more than 12 months after the end of the basis period for 2010–11, your basis period is the period between the end of the basis period for 2010–11 and the new accounting date.

Example 5

If the basis period for 2010–11 ended on 31 May 2010 and the new accounting date is 31 August 2011, your basis period is the 15-month period 1 June 2010 to 31 August 2011.

- If your accounting date in 2011–12 is less than 12 months after the end of the basis period for 2010–11, your basis period is the 12 months ending on the new accounting date.

Example 6

If the basis period for 2010–11 ended on 31 December 2010 and the new accounting date is 31 July 2011, your basis period is the 12-month period 1 August 2010 to 31 July 2011. (See also the section on overlap profit.)

Conditions for change of accounting date

The following conditions apply if you want a change of accounting date in year 4 onwards to count for tax purposes:

- You are required to let us know in your tax return (box 3.12 on the Partnership Tax Return or box 10 on page SEF 1) and to send back your tax return by the relevant filing date.
- The first accounts to the new accounting date must not exceed 18 months and you must give the reasons why the change has been made.
- If you changed accounting date in any of the previous 5 tax years this change must be for genuine commercial reason. Obtaining a tax advantage is not a commercial reason.

If you fail to do this, the change of accounting date will not count for tax purposes.

What to do if your basis period is not the same as your period of account

Your basis period for 2011–12 may be different from the period (or periods) for which your accounts are made up. If so, you must calculate the profit of the basis period by adding together and/or dividing the periods for which you have accounts. But see the note on page 7 if your accounting date falls between 31 March and 4 April.

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Example 7

Your business started on 6 April 2011 and your basis period is the 12 months to 5 April 2012. But your accounts are made up for the three months to 30 June 2011 (profit £4,500) and the 12 months to 30 June 2012 (profit £24,000). So your basis period covers three months of your 2011 accounts and nine months of your 2012 accounts.

The profit of the basis period will be: $£4,500 + (\frac{280}{366} \times £24,000) = £22,860$.

These calculations should strictly be made in days, but weeks, months or fractions of years may be used instead.

Accounting dates between 31 March and 4 April

The basis of assessment for the tax year in which a business commences (Year 1) is usually the profits arising in that tax year. But where a new business chooses an accounting date between 31 March and 4 April the accounts for the opening years are treated, unless you elect otherwise, as though they were prepared to 5 April.

This will have the effect that:

- the profits of the account to 31 March or 1, 2, 3 or 4 April each year will be taxed as though they were for the period to the following 5 April. Over the lifetime of the business, the full profits must, of course, be taxed
- for businesses which commence in the period 1 to 5 April, the taxable profits for Year 1 will be zero.

This treatment will not affect any other matters which depend upon the date, or tax year in which the business commences.

You may also treat a change of accounting date where the new date is 31 March or 1, 2, 3 or 4 April as though it was a change to 5 April.

All previous overlap profits will accordingly be deductible in the year the change takes effect for tax purposes. If you are in doubt, ask us or your tax adviser for help.

Overlap profits

It may be that your basis period for 2011–12 overlaps with the basis period for 2010–11. Such overlaps can occur in the first three years after a business starts up or in a year in which there is a change of basis period (because your accounting date has changed).

Example 8

Your business started on 1 January 2011 and your first account is for the 12 months to 31 December 2011. Your basis periods are:

2010–11: 1 January 2011 to 5 April 2011

2011–12: 1 January 2011 to 31 December 2011.

The period of overlap is 1 January 2011 to 5 April 2011. So, if the profit of the 12 months to 31 December 2011 is £12,000, the overlap profit is $(\frac{96}{366} \times £12,000) = £3,147$ (over 96 days).

If your basis periods for 2010–11 and 2011–12 overlap, you should keep a record of both the overlap profit and the overlap period. Any overlap profit you have is carried forward until such a time as you can claim overlap relief. The amount of your overlap profit to be carried forward should be entered in box 69 on page SEF 4 (or box 13 of the *Partnership* pages).

Overlap relief used this year – box 68 on the *Self-employment (full)* pages (or box 12 of the *Partnership* pages)

Enter in box 68 on page SEF 4 (or box 12 of the *Partnership* pages) any overlap relief you are allowed to deduct for 2011–12. The notes below will help you work out how much overlap relief to deduct.

Overlap profits which arose in 2010–11 or earlier years must be deducted as overlap relief in working out your taxable business profits for 2011–12 if:

- you sold or closed down your business in 2011–12. All the overlap profits brought forward should be entered at box 68 (or box 12), or
- your basis period for 2011–12 is more than 12 months long because you have changed your accounting date since last year. The amount of overlap profits allowed as overlap relief is in proportion to the length of your basis period in excess of 12 months and the length of your overlap period from earlier years. Example 9 shows how this works.

Example 9

You have overlap profit of £5,000 (over five months) from an earlier year. You change your accounting date. Your basis period is 14 months and you are therefore entitled to overlap relief. There are five months of overlap profit available. The relief is in proportion to the number of months by which the basis period exceeds 12 months (that is, two months) and the length of the overlap period (that is, five months).

So the relief is:

$$\frac{2}{5} \times £5,000 = £2,000.$$

The balance of overlap profit, £3,000 (over three months), is carried forward. You will claim this as overlap relief in a later year.

Capital allowances and balancing charges

In working out your business profits you should not deduct the cost of buying or improving items such as the car, equipment and other tools that you use in your business or the depreciation or any other losses which arise when you sell them. Instead, you can claim tax allowances called capital allowances. These are deducted to arrive at your taxable profits.

An adjustment, known as a balancing charge, may also arise when you sell an item, give it away or stop using it in your business. Balancing charges must be added back to arrive at your taxable profits.

More information can be found in Helpsheet 252 *Capital allowances and balancing charges*.

Losses – terminal relief

If your business ceased in 2011–12 and you made a loss in your final 12 months of trading, a terminal loss, you can claim terminal loss relief against profits from the same trade profession or vocation taxed in 2011–12. If any terminal loss remains, relief is by reference to the profits of the trade, profession or vocation of up to three earlier years. **The time limit for this claim is 5 April 2016.**

This is an alternative to the other ways in which losses can be relieved. You can find information on losses generally at www.hmrc.gov.uk or you can ask the SA Orderline for Helpsheet 227 *Losses*. However, make sure that you do not claim the same loss twice.

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How to calculate your terminal loss

You should refer to the examples and Working Sheet on the following pages to calculate your terminal loss. Typically, if your 2011–12 accounts cover a period of:

- 12 months, the terminal loss is the allowable loss plus any unused overlap relief
- more than 12 months, the terminal loss is a 12-month proportion of the allowable loss, plus any unused overlap relief
- less than 12 months, the terminal loss is the loss of the period 6 April 2011 to the date the business ceased plus any unused overlap relief and any loss in the period starting 12 months before the business ceased to 5 April 2011.

In each of the following examples, unused overlap relief is assumed to be £2,000.

Example 10

Your accounts covered 15 months to your cessation of trading on 31 October 2011, and the allowable loss is £5,000. Your terminal loss is:

Loss for the period 6 April 2011 to 31 October 2011:

$\frac{7}{15} \times £5,000$	£2,333
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Plus

Overlap relief	£2,000
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Loss for the period 1 November 2010 to 5 April 2011:

$\frac{5}{15} \times £5,000$	£1,667
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Terminal loss	£6,000
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If your 2011–12 accounts cover a period of less than 12 months, you need to add on part of the allowable loss (if any) from the 2010–11 accounts to make the terminal loss up to 12 months.

Example 11

Your accounts covering six months to your cessation of trading on 30 September 2011 show a loss of £8,000. You had a loss of £7,500 in your accounts for the nine months to 31 March 2011. You need to add six months to bring your terminal loss to 12 months:

Loss for the period 6 April 2011 to September 2011

£8,000

Plus

Overlap relief	£2,000
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Loss for the period 1 October 2010 to 31 March 2011 - $\frac{6}{9} \times £7,500$

£5,000

Terminal loss	£15,000
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If your 2011–12 accounts cover a period of less than 12 months, and the 2010–11 accounts show a profit, you need to calculate the loss or profit for the part of the final 12 months of trading that falls in the tax year when you permanently cease the trade and the loss or profit for the part of the final 12 months of trading that falls in the previous tax year.

Example 12

Your accounts covering eight months to your cessation of trading on 30 September 2011 show a loss of £8,000. You had a profit of £7,500 in your accounts for the 12 months to 31 January 2011. The position is as follows:

Loss for the period 6 April 2011 to 30 September 2011 - $\frac{6}{8} \times £8,000$	£6,000
Plus	
Overlap relief	£2,000
Loss for the period 1 February 2011 to 5 April 2011 - $\frac{2}{8} \times £8,000$	£2,000
Profit for the period 1 October 2010 to 31 January 2011 - $\frac{4}{12} \times £7,500$	(£2,500)
Net profit	(£500) treat as nil
Terminal loss	£8,000

In each of these examples the unused overlap relief enhanced the terminal loss. The Working Sheet below will help you work out your terminal loss.

Allowable loss for 2011-12

Unused overlap relief

A £

Add either:

if this account is more than 12 months, deduct a proportion of the loss to leave 12 months' worth of loss

B £

or

if this account is less than 12 months, add part of the allowable loss (if any) from earlier accounts to make up the 12-month period to the date your business ceased

C £

or

if this account is less than 12 months and there is a net business profit in the final accounts or in the previous accounts, add the allowable loss (if any) relating to the part of the final 12 months trading falling in the tax year 2011-12 to the allowable loss (if any) relating to the part of the final 12 months trading falling in the tax year 2011-12

D £

Terminal loss (box A + box B or box C or box D)

E £

If you have already claimed relief for any part of the loss above, then you must reduce the terminal loss by the amount of relief that you have already claimed. This is because you can only have relief once for each £1 of loss.

Your terminal loss must be set against any profits (after deducting losses brought forward) from the same business taxed in 2011-12. If these are zero, it must be set against profits from the same business taxed in 2010-11. Once these have been reduced to zero any balance of the terminal loss must be set against the profits of the same business taxed in 2009-10. Finally, if there is still a balance, this must be set against the profits of the same business taxed in 2008-09.

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Enter the amount of terminal loss relief you are claiming against your 2011–12 profits at box 73 on page SEF 4 or box 15 on the *Partnership* pages as a loss brought forward and used this year. This is in addition to any other losses you are bringing forward from earlier years, but make sure you do not count the same loss twice. Enter the total amount of terminal loss relief for 2010–11, 2009–10 or 2008–09 in box 78 on page SEF 4 or box 21 on the *Partnership* pages and give details of the amount carried back to each year in the ‘Any other information’ box, box 102 on page SEF 6 of your *Self-employment (full)* pages or in the ‘Any other information’ box, box 19 on your tax return.

If you have been sent your tax return for the year in which your business ceased then you must make your terminal loss relief claim in your tax return. If you have not been sent your tax return yet then you can claim terminal loss relief as soon as you know how big the loss is, usually when the final accounts have been prepared for the business. If you want to claim terminal loss relief before you receive your tax return, write to us.

Your letter should include:

- the name of your business
- that you want to claim terminal loss relief
- the date your business ceased
- the profit or loss of the business from the end of the last basis period to the date the business ceased, calculated in accordance with the guidance in the *Self-employment notes* and elsewhere in this helpsheet
- the terminal loss that you have calculated following the above guidance.

Partners' trading or professional profits

The basis period and overlap rules detailed above are applied to your share of the partnership's trading and professional profits (or losses) as if that income had arisen to you from a trade which you carried on alone, as a sole trader.

That trade will be deemed to have commenced on the date you became a partner (unless you previously carried on the business on your own account when it will be deemed to have commenced on the date you started the business) and deemed to have ceased on the date on which you ceased to be a partner (or if you carry on the trade thereafter as a sole trader, on the date you cease to carry on that trade).

Example 13 Basis period rules for partners

The partnership commenced trading on 1 October 2009 and makes up its account each year to 30 September. You cease to be a partner on 31 December 2011. Your share of trading profits as shown in the Partnership Tax Returns is as follows:

year ended 30 September 2010	£12,000
year ended 30 September 2011	£18,000 (A)
year ended 30 September 2012	£7,000 (B)

Your basis periods for each fiscal year and the overlap relief to which you are entitled are as follows:

2009-10: 1 Oct 2009 to 5 April 2010	profits	£6,000
2010-11: 1 Oct 2009 to 30 Sept 2010	profits	£12,000
(overlap period 6 months: overlap profits £6,000) (C)		
2011-12: 1 Oct 2010 to 31 Dec 2011	profits	£25,000 (A) + (B)

Minus

Overlap relief	£6,000 (C)
Taxable profit	£19,000 (D)

In the *Partnership* pages, enter £18,000 in box 7, £7,000 in box 8, £6,000 in box 12 and £19,000 in boxes 14, 16 and 18.

If, as a partner, you are unsure how the basis rules apply to you, ask us or your tax adviser for help.

Other partnership income

The basis period rules to be applied to your share of the partnership's non-trading or professional income are described below.

If the partnership carried on a trade or profession in 2011–12 then the basis period will depend on whether tax has been deducted from that income.

Your share of the partnership's non-trading or professional income from which no UK tax has been deducted, 'untaxed income', is treated as having been derived from a 'notional' business which you carried on alone. The same basis period and overlap rules which are applied to your share of the partnership's trading or professional profits are applied to the 'notional' business which is treated as carrying on. But for this purpose the 'notional' business is deemed always to have commenced on the date you became a partner and to have ceased on the date you ceased to be a partner.

Any overlap relief to which you may be entitled from your 'notional' business is first to be relieved against any other untaxed income (regardless of the source from which it is derived) and the balance is to be given as a deduction against any other income of that year.

For your share of the partnership's non-trading or professional income from which UK tax has been deducted, 'taxed income', your basis period is the tax year. This is the period 6 April 2011 to 5 April 2012.

If the partnership did not carry on a trade or profession in 2011–12 then your basis period for both 'untaxed' and 'taxed' income is the tax year 6 April 2011 to 5 April 2012.

The provision of personal services through a partnership – deemed employment payment

If the partnership provides a partner's services or the services of others to clients, then new rules about tax and National Insurance contributions (NICs) introduced from 6 April 2000 may apply. The rules will apply to the

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partner and the partnership if they can answer 'yes' to both the following questions:

- would the partner be an employee if they worked for the client directly and not through the partnership?
- does the partnership the partner works through meet the conditions set out below?

The following conditions have to be met before the new rules can apply:

- the partner (or their family) is entitled to 60% or more of the profits of the partnership, or
- all or most of the partnership's profits come from providing services to a single client, or
- the profit-sharing arrangements in the partnership are designed to make sure that the partner receives an amount based upon the amounts received for their services to clients.

If the rules apply then the partner may have to pay an additional amount of tax and NICs, based on the payments received by the partnership for the partner's services, at the end of the tax year or earlier if the partner ceases to be a partner during the year. This additional amount, which is known as a deemed payment, is treated as income from employment with the partnership. The partnership will have to apply PAYE and deduct NICs from this deemed payment. The partner will have to return this amount on a set of *Employment* pages in box 1, and record any tax deducted in box 2.

If the rules apply to the partnership then, in calculating its profits for tax purposes, a deduction is allowed for:

- the amount of the deemed payment, and
- the amount of any secondary Class 1 NICs paid on it.

The deduction is allowed once as a tax adjustment in calculating the taxable income of the partnership. Relief is given against the profits for the accounting period in which the deemed payment is treated as made (this will normally be 5 April) and is not to be apportioned between the partnership's accounting periods where the partnership makes up its accounts to a date other than 5 April.

The amount of the deduction allowed in calculating the profits is limited to the amount that reduces those profits to nil. Therefore a deemed payment and the secondary NICs on that payment cannot create a loss.

Where the partnership expenses incurred for the relevant engagements exceed the sum of:

- the expenses allowable in calculating the deemed payment, and
 - the 5% flat-rate allowance allowable in calculating the deemed payment
- then the excess amount is left out of account in calculating the taxable profits.

The adjustment for disallowable expenses should be made at box 3.66 of the Partnership Tax Return. The amount of the deemed payment and any secondary Class 1 National Insurance contributions should be included at box 3.71 of the Partnership Tax Return (if a deduction has already been made for any secondary Class 1 National Insurance contributions in the accounts, for example under employee costs, then that amount should be included in the figure at box 3.66). You should explain how you arrived at these figures in the 'Additional information' box, box 3.116, on page 3 of the Partnership Tax Return.

Example 14 Deemed payment calculation

Mr and Mrs Jones carry on trade in partnership and make up their accounts to 5 April 2012. All the partnership's income is derived from contracts covered by the new rules. Profits are split equally but Mrs Jones performs the services.

Partnership Accounts year ended 5 April 2012

Income	£20,000
Expenses (A)	£5,000
Profit	£15,000

Allocated Mrs Jones £7,500 and Mr Jones £7,500

Of the partnership's expenses, only £2,000 of the £5,000 would be allowable under employment income rules.

Calculation of deemed payment on 5 April 2012

Income from relevant engagements	£20,000
Minus	
5% flat-rate allowance (£20,000 x 5%) (B)	£1,000
Employee expenses (C)	£2,000
Secondary Class 1 NICs on deemed payment	£1,374
Deemed payment	£15,626

Recalculation of partnership's taxable profit

Partnership profit (enter at box 3.65)	£15,000
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Add

Disallowed expenses (A) minus (B + C)	
£5,000 minus (£1,000 + £2,000)	£2,000
(enter at box 3.66)	£17,000

Please note: The disallowed expenses are the excess of the partnership expenses in the accounts (A) over the sum of the 5% flat-rate allowance (B) and employee expenses (C).

Minus

Secondary Class 1 NICs on deemed payment	£1,374	
Deemed payment (enter at box 3.71)	£15,626	£17,000
Taxable trading profit (enter at box 3.73)		0

Please note: The deemed payment amount is always restricted to an amount that reduces the trading profit to nil.

These notes are for guidance only and reflect the position at the time of writing. They do not affect any rights of appeal. Any subsequent amendments to these notes can be found at www.hmrc.gov.uk