A STEALTH TAX INTRODUCED BY ACCOUNTANTS?

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Introduction

This article analyses the recent changes to accounting practice and how these might lead to an acceleration of taxable profits – particularly for professional practices.

Background – The relationship between accounting and taxable profits

Although traders have for many years been assessed on the profits of their trade, there was until relatively recently no statutory guidance on the quantification of a taxpayer's taxable profits.

However, the Courts have long held that the starting point should be the profits as calculated for the purposes of commercial accountancy. In *The Sun Insurance Office v Clark (Surveyor of Taxes)*[2], Lord Haldane held:

> *It is plain that the question of what is or is not profit or gain must primarily be one of fact and of fact to be ascertained by the tests applied in ordinary business. Questions of law can only arise when (as was not the case here) some express statutory direction applies and excludes ordinary commercial practice, or where, by reason of its being impracticable to ascertain the facts sufficiently, some presumption has to be invoked to fill the gap.*

Nevertheless, even in the early 1990s the relationship between accounting and

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2 (1911-1915) 6 TC 59

taxable profits was being argued in the Courts. In *Gallagher v Jones*[3], the High Court was minded to permit the deduction of lease payments in the year that they were incurred even though accountancy principles required them to be spread over a number of years. As Sir Thomas Bingham MR commented, however, when the case was subsequently heard on appeal, the parties did agree on a number of points:

> *They agreed that in the ordinary way the computation of a taxpayer's trading profits and losses for tax purposes must be made according to the ordinary principles of commercial accountancy. But they also agreed that the application of such principles is subject to any rule of tax law, statutory or otherwise, which precludes or limits such application.*

The disagreement between the parties in that case was whether there was a special rule of tax law that applied to payments made under leasing agreements. Having analysed a number of cases spanning the previous 120 years, the Master of the Rolls (with whom Nolan LJ and Sir Christopher Slade agreed) held that there was no such rule.

Nevertheless, until 1999, professional firms (as opposed to persons carrying on trades) were entitled to deviate from accounting practice under the provisions of Statement of Practice A27. Such firms were entitled to recognise income only when it was received, thereby deferring income still in the form of work in progress or a debtor balance. This distinction was described in December 1997 by a Government press release as "an anomaly for which there is no justification" paving the way for what became section 42 of the Finance Act 1998.

In its original form, section 42 made it clear that when calculating the profits of any business[4] for tax purposes, the computation had to be "on a basis which gives a true and fair view" subject to any rule of law which required an adjustment to be made to those profits. Section 42 had effect with respect to any period of account beginning on or after 7th April 1999.

Section 42 has since been amended by section 103(5) of the Finance Act 2002. Section 103(5) removed the reference to "true and fair" and replaced it by the requirement that any computation of profits had (subject to any rule of law to the contrary) to be "in accordance with generally accepted accounting practice". Since 6th April 2005, section 42 has been relevant only to corporation tax; for

3 [1994] Ch 107; [1994] 2 WLR 160; [1993] STC 537; 66 TC 77

4 therefore encompassing trades, professions and vocations – and property businesses by extension

income tax purposes, the rule is now found in section 25 of the Income Tax (Trading and Other Income) Act 2005.

Therefore, subject to two exceptions, whether an element of expenditure is to be allowed as a deduction when calculating a taxpayer's profits (or, conversely, whether an item of income is to be taxed as such in a particular accounting period) is a matter of generally accepted accounting practice. The two exceptions (which, strictly, could be viewed as the only exception and one manifestation of it) are:

(1) where there is a specific rule of law requiring or authorising the profits to be calculated on a different basis; and

(2) where the profits to be calculated are those of a barrister or advocate in the early years of practice.[5]

The impact of Finance Act 1998

Thus, for accounting periods commencing after 6th April 1999, professional practices had to comply with accounting standards when calculating their taxable profits. In particular, professional income would have to be valued in accordance with the rules for stock and work in progress.

Once an invoice is rendered (except when the invoice represents work not yet done), the invoiced amount would represent part of a firm's turnover even if it has not yet been paid. However, amounts could become recognisable as income long before the invoice is ever prepared. Under Statement of Standard Accounting Practice 9) work-in-progress is required to be recognised at the lower of cost and net realisable value.

Most professional firms would have recorded their work-in-progress by showing the chargeable hours spent on a particular client and the charge-out rate relevant to the particular member of staff. In an ideal world, the work-in-progress would represent the net realisable value of the work performed for the particular client.

5 This exception, now found in section 160 of the Income Tax (Trading and Other Income) Act 2005 was first introduced in Finance Act 1998 in recognition of the fact that many junior barristers (particularly those practising in criminal law) are paid in some cases years after the work is performed.

In any event, in most cases, this figure would exceed the cost to the firm.[6] It would be the latter which would need to be recognised in the accounts.

The profit element of any work-in-progress would ordinarily be first reflected in the accounts when the invoice is rendered to the client.

The transition to Finance Act 1998 compliance

As part of the measures introduced by Finance Act 1998, section 44 and Schedule 6 provided rules dealing with the transition from the pre-Finance Act 1998 régime to the post-Finance Act 1998 régime. Calculating the profits of a business from one year to the next normally presupposes that the profits would be calculated on a similar basis in the different years. Therefore, a change of accounting basis could give rise to expenses or income not being recognised (or being recognised twice).

For example, if a law firm were to compute its 1999 profits on the basis of cash received, but its 2000 profits on the earnings basis (the name of the basis which recognises income as it is earned and not necessarily when it is received), the likelihood is that some income would be overlooked. This would be the income that would have been earned in 1999 but not received until some time after the end of that year.

Under paragraph 2 of Schedule 6, such income had to be treated as arising on the first day of the first accounting period in which the new accounting basis is adopted.[7] For many firms, this paragraph 2 charge would have been quite significant. Consequently, paragraph 4 permitted the charge to be spread over ten years.

6 In fact, where the work-in-progress shows only the time of the proprietor (or partners) of the professional firm, the cost to the firm would be either nil or, where there are fixed overheads, a share of these expenses. When employees' time is included in the work-in-progress, the cost element must represent the salaries (and associated costs) rather than any profit element inherent in the charge-out rates.

7 This requirement gave rise to the anomaly that, whilst the statute seemed to want to relate it to the accounting period in which the new accounting basis was adopted, in most income tax cases it was actually taxed in the tax year relating to the old accounting basis. The exception was in cases where the new accounting basis was used in an accounting period which began on 6th April.

The revisions of Finance Act 2002

The change of wording from "true and fair" to "generally accepted accounting practice" has already been referred to. However, Finance Act 2002 also revised the transitional rules that apply when a business changes from one authorised accounting basis to another. Under section 64 of, and Schedule 22 to, the Finance Act 2002, any catch-up charge is now brought into account as income on the last day of the first accounting period subject to the new accounting basis. This defers the charge until the tax year in which it makes more logical sense for it to be brought into account. However, the Finance Act 2002 precludes the 10-year spreading rules from applying in most cases. These rules now apply exclusively to barristers and advocates when they leave the cash (or a hybrid) basis for the earnings basis.[8]

The changes in accounting practice

Like tax law, the rules and guidance for the accountancy profession are not static. In the United Kingdom, the responsibility for developing such guidance falls to the Accounting Standards Board, which is now part of the Financial Reporting Council. As with much tax law, some of the ASB guidance operates at a high level dealing with overriding principles whereas some focuses on particular transactions.

The introduction of FRS 5

Since 1994, one part of the high level guidance has been Financial Reporting Standard 5 ("FRS 5") Reporting the Substance of Transactions. Reporting the substance of a transaction rather than its strict legal form is the accountancy equivalent to the alchemy performed by the House of Lords in *Ramsay*[9]. In itself, the concept is probably not controversial. FRS 5 was not the first piece of guidance requiring the accountancy profession to look at the underlying substance of a transaction; this is acknowledged in paragraph b of the Summary of FRS 5 itself which reads:

> *The FRS will not change the accounting treatment and disclosure of the vast majority of transactions. It will mainly affect those more complex transactions whose substance may not be readily apparent.*

8 paragraph 11 of Schedule 22 to Finance Act 2002 (now section 238 of the Income Tax (Trading and Other Income) Act 2005).

9 *WT Ramsay Ltd v IR Commissioners* [1982] AC 300

Paragraph 1 of FRS 5 nevertheless states:

> *The objective of this FRS is to ensure that the substance of an entity's transactions is reported in its financial statements. The commercial effect of the entity's transactions, and any resulting assets, liabilities, gains or losses, should be faithfully represented in its financial statements.*

FRS 5, however, forms only part of the guidance to the accountancy profession – the other FRSs (and the Statements of Standard Accounting Practice ("SSAPs") which preceded FRSs) need to be considered as well.

Appended to FRS 5 were five "Application Notes". These notes specify how FRS 5 is to be applied to certain situations. These situations are:

A Consignment Stock

B Sale and Repurchase Agreements

C Factoring of Debts

D Securitised Assets

E Loan Transfers

It is stated that "observance of the Notes [in the relevant situations] will normally be sufficient to ensure compliance with the requirements of FRS 5".

Amendments to FRS 5

A sixth Application Note dealing with accounting for PFI projects followed in 1998. However, it was the introduction of Application Note G in November 2003 (with effect for accounting periods ending on or after 23rd December 2003) which has given rise to the controversy.

Much of this controversy has been argued by tax professionals rather than by those concerned solely with matters of accountancy. The introduction of Application Note G was, however, not universally welcomed by the accountancy profession. In fact, one member of the Accounting Standards Board voted against its introduction. However, that opposition (whilst not wholly irrelevant to the subject matter of this article) was based more upon the impact that the Application Note would have on accounting standards than the impact the Note would have on tax liabilities.

Whereas the first six Application Notes deal with matters that are, to an extent at least, rather specialised (and where there is clearly a risk that the substance of a transaction could be masked by its legal form), Application Note G deals with a far more fundamental principle – Revenue Recognition – i.e. when is income to be recognised as part of turnover in a business's accounts. The wide scope of the Note is acknowledged in the first paragraph of the Note itself:

> *This Application Note deals with revenue recognition from the supply of goods or services by a seller to its customers. It sets out basic principles of revenue recognition which should be applied in all cases. It also provides specific guidance for [certain specified more specialised cases].*

The Basic Principles of Application Note G

Paragraph G4 of the Note provides:

> *A seller recognises revenue under an exchange transaction with a customer, when, and to the extent that, it obtains the right to consideration in exchange for its performance. At the same time, it typically recognises a new asset, usually a debtor.*

The situation where a contractual supply is not fully made by the accounting date is dealt with by paragraphs G6 and G7

> *A seller may obtain a right to consideration when some, but not all, of its contractual obligations have been fulfilled. Where a seller has partially performed its contractual obligations, it recognises revenue to the extent that it has obtained the right to consideration through its performance.*
> *Revenue should be measured at the fair value of the right to consideration. Subject to paragraphs G8 [time value of money to be taken into account only if material] – G9 [where there is a significant risk of default by the buyer] or other evidence to the contrary, this will normally be the price specified in the contractual arrangement, net of discounts, value added tax and similar sales taxes.*

The Application Note then proceeds to discuss the specialised cases referred to earlier on.

The controversy caused by Application Note G

The controversy caused by Application Note G has been based upon its interpretation in relatively straightforward cases. Suppose a tax adviser is engaged in the preparation of a client's tax return. Alternatively, suppose a solicitor is preparing a detailed trust document or is in the middle of negotiating a detailed contract.

If an accounting date falls before these tasks are complete, how should time "on the clock" at the accounting date be recognised in the accounts? Conventionally (at least, ever since Finance Act 1998), it has been the practice for the work-in-progress to be shown at the lower of cost (usually relatively modest) and net realisable value. However, Application Note G appeared (at least to some commentators) to change this. At the heart of the debate is the question: is there a right to consideration at the accounting date and, if so, what is the fair value of this right?

In an accompanying note to the Application Note, the Accounting Standards Board reported as follows:

> *The principle that a seller generates revenue by performing its contractual obligations to the customer is consistent with the idea of performance under the law of contract.*

In a footnote, the ASB cites Sir Guenter Treitel's *The Law of Contract*:

> *A party who performs a contract in accordance with its terms is thereby discharged from his obligations under it. Such performance also normally entitles him to enforce the other party's undertakings.*

The text of Application Note G had previously been subject to public consultation. The final version was accompanied by an explanatory memorandum which discussed some of the points arising. One of the areas so discussed is the matter of partial performance of contracts:

Partial performance

24 Some respondents requested further clarification as to how the principles in the Exposure Draft should be applied to situations where the seller's contractual performance is incomplete.

25 The final Application Note contains additional guidance on this issue. It states that there will be some arrangements where the seller obtains a right to consideration when some, but not all, of its contractual obligations have been fulfilled. Where a seller has partially performed its contractual obligations, the Application Note stresses that it recognises

revenue to the extent that it has obtained the right to consideration through the performance of its contractual obligations in supplying goods and services.

26 Obtaining the right to consideration does not necessarily involve delivery or the transfer of title. For example, if a seller is constructing a building to a customer's design, the customer may gain neither title nor physical custody until construction is complete. Nevertheless, the seller obtains the right to consideration through its performance as construction activity progresses, reflecting the value of the work performed to date.

It is clear therefore that concern had been raised about how to recognise income when a contractual activity is incomplete at the relevant accounting date. Despite this forewarning, it became apparent that the attempts to clarify the matter failed.

A very public debate

One of the first (if not the first) articles written following the publication of Application Note G was that by Andrew Disley in *Taxation*.[10] He warned of the potential cost for the larger professional firms that could run into the millions and tens of millions of pounds as previously unrecognised income (the profit elements of partners' and staff time) would have to be reflected in the taxable profit for the first time. Andrew Disley further pointed out that, whilst the absolute cost would be the largest for the larger firms, many smaller entities would be relatively worse off as they would often have fewer (and, sometimes, no) employees contributing to the work-in-progress figure. Consequently, these smaller entities might not have been showing any work-in-progress figure in their accounts until the introduction of Application Note G.

This warning was, however, viewed as unnecessary by Robert Maas.[11] In Robert Maas's view, a firm of accountants could not generally charge a client for a partially-completed tax return. Therefore, so Robert says, it is difficult that a right to consideration arises until such time as the client has something worth paying for.

This was also the view of the Association of Taxation Technicians. In March 2004 they gave the following unequivocal advice to their members:

It has been suggested that the issue of Application Note G means that

10 'More Bad Tax News for the Professionals', *Taxation*, 22nd January 2004, pp376-378

11 'The WIP wrangle', *Taxation*, 12th February 2004, pp376-378

> *work in progress will now have to be valued at selling price in all cases, even where the unbilled time includes that of partners and proprietors. As the Application Note has effect for accounting periods ending after 23rd December 2003, concern was expressed that unincorporated businesses would be faced with increased and unexpected tax bills for 2003-04.*
>
> ***Members should note that these concerns are without foundation.*** *Application Note G is unequivocal; at paragraph G2 it says that it does not apply to arrangements "which are dealt with more specifically elsewhere in this or other accounting standards", whilst at paragraph G14 it says "SSAP 9 sets out requirements for accounting and disclosure under a long-term contract. The Application Note provides additional guidance on the recognition of turnover derived from such contracts, but does not amend the requirements of that accounting standard." The development of the Application Note was to meet a situation where differing interpretations had arisen of when revenue should be recognised and to address concerns that businesses were in fact anticipating income which had not yet arisen in order to satisfy investors' expectations of growth.*
>
> *Members should therefore be assured that the valuation of work in progress should continue to be made in accordance with SSAP 9 at the lower of cost or net realisable value.*
> *[emphasis added]*

In my view, the wording of Application Note G (and its accompanying notes) made it clear that the accountancy profession was attempting to do no more that replicate the position under the law of contract.

The position is best summarised by returning to *Treitel*:[12]

> *In general, a person who failed to complete performance of an entire obligation could not recover anything; but...this rule was subject to a number of exceptions.*
>
> *Under some of these, there is a right to payment of the contract price or at the contract rate.*
>
> *Under others, there is a right to a quantum meruit (or reasonable remuneration): for example, where a benefit conferred by partial performance of services is "voluntarily" accepted by the other party.*

12 In the tenth edition (as considered by the Accounting Standards Board) at pages 989-990; in the newer eleventh edition at pages 1062-1063.

> *In a number of further exceptional cases, a reasonable sum is, or may be, payable for services rendered by the party in breach even though the services differ from, or fall short of, those bargained for, even though there has been no "voluntary" acceptance of them by the injured party, and even though the contract remains in force.*

The problem with this analysis (a comment since made by Peter Vaines[13]) is that it is predicated on the assumption that there has been a breach of contract. In the vast majority of cases, however, Application Note G to FRS 5 is concerned with ongoing contracts where, for accountancy (and hence tax) purposes, one is required to evaluate the right to receive consideration. However, in my view, one would usually reach the same conclusion by adopting the approach taken by Robert Maas. Is there, at the accounting date, a finished 'product' which one can take to a client and charge a partial fee?

An alternative view

An alternative view, however, could be formed – not by considering FRS 5 but instead by considering the longer established accounting standard, SSAP 9 – stock and long-term contracts.

As previously suggested, the normal rule for stock is that it should be recorded at the lower of cost and net realisable value. However, this is not the case for "long-term contracts".

As a general rule, a long-term contract would be one lasting over a year. This could encompass certain intricate contractual negotiations and the administration of many estates. Conversely, most agreements to prepare a tax return would not last over a year. However, one should not concentrate too much on the one-year test. As SSAP 9 itself says:

> *Some contracts with a shorter duration ... should be accounted for as long-term contracts if they are sufficiently material to the activity of the period that not to record turnover and attributable profit would lead to a distortion of the period's turnover and attributable profit would lead to a distortion of the period's turnover and results such that the financial statements would not give a true and fair view.*

When one is dealing with a long-term contract, it is often appropriate to bring into the accounts the profits attributable to the earlier accounting period as

13 'Unfinished Business?', *Taxation*, 2nd June 2005, pp231-233

calculated on a prudent basis.

On this basis, delaying revenue recognition until an invoice is raised (or the fee is paid, if earlier) might be the incorrect accounting treatment in any event. Of course, dealing with long-term contracts requires a careful analysis of all of the surrounding circumstances. In particular, one needs to determine (using the accountants' concept of materiality) whether it is appropriate to treat a particular agreement as subject to the rules dealing with long-term contracts.

However, it is my view that, strictly speaking, in many cases (but not all) it would be appropriate to treat the preparation of tax returns as long-term contracts. For example, suppose a sole practitioner starts to practise as a tax adviser on 1st May 2005. Between then and 31st December he is busy preparing the tax returns due on 31st January 2006; as at 31st December, the returns are almost but not quite complete. In the first week of January 2006, the adviser finishes and sends out the returns to the clients in the hope that they come back by the end of the month. Invoices are then raised. Accounts are prepared to 31st December.

At 31st December 2005, the lower of cost and net realisable value will be relatively modest. However, the bulk of the work would have been performed by that date and to defer any recognition of this until the following year could distort the adviser's accounts. Consequently, in my view, it would be appropriate to treat these contracts (spanning two accounting periods) as long-term contracts. Subject to the adviser's clientele, the financial outcome (as far as the adviser's fees are concerned) would be reasonably certain and it would therefore be appropriate (indeed, obligatory) for some of the profit to be recognised in 2005.

The final word?

Where there is uncertainty surrounding an accounting standard or a Companies Act requirement, a branch of the Accounting Standards Board, the Urgent Issues Task Force ("UITF"), will often issue an "abstract" giving additional guidance where necessary. Compliance with an abstract will usually be compulsory if accounts are to comply with generally accepted accounting practice.

In view of the uncertainty generated by Application Note G, abstract 40 from the UITF ("UITF 40") was published in March 2005. That abstract made it clear that the previous debates concerning the relevance of Application Note G were overlooking the more fundamental point that many of the contracts under consideration were in fact subject to SSAP 9 as long-term contracts as set out above.

It has been stated that the decision to treat a contract as a long-term contract is partly a function of materiality; individual contracts entered into by a professional firm are unlikely to be material by themselves. UITF 40 makes it clear that, when considering the materiality point, one should look at the contracts in the aggregate.

Whilst the publication of a UITF abstract ought to be the final word on the matter, the following six months have seen yet more debate in the pages of *Taxation* as to how professional firms' profits should be calculated.

Many of the protagonists are debating whether or not Application Note G was intended to cover ordinary professional working contracts, such as the preparation of a set of accounts or the conduct of litigation. From this basis of dispute, the protagonists then seek to argue whether or not a firm's taxable profits should be recognising some income not yet invoiced or received.

However, as the editor of *Taxation* points out[14], the debate has moved on. These protagonists are by and large taxation specialists. At the heart of the dispute is a matter of accounting. As now provided for by statute, the starting point when calculating the profits for tax purposes is the profit as calculated in accordance with generally accepted accounting practice.

In my view, many of the contracts under consideration have for many years been subject to the SSAP 9 rules dealing with long-term contracts. Whilst this may represent a strict interpretation of accounting standards, I recognise that this practice has not been universally adopted (if, in fact, it had been adopted at all). Therefore, I would concede that whilst representing *best* practice, it did not accord with "generally accepted" accounting practice.

Indeed, the flurry of correspondence following the publication of Application Note G includes a letter[15] from the Accounting Standards Board to the Chartered Institute of Taxation. This letter suggests that this non-compliance with SSAP 9 became apparent only when people started debating the impact of Application Note G.

By publishing UITF 40, the relevance of SSAP 9 in many cases has now become apparent. UITF 40 must be complied with for accounting periods ending on or after 22nd June 2005. Because of the widespread non-compliance with SSAP 9 for earlier accounting periods, it is arguable that overlooking SSAP 9 would not have breached generally accepted accounting practice. Consequently, it would

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14 'The last word', Mike Truman, *Taxation*, 29th September 2005, pp720-722

15 http://www.tax.org.uk/attach.pl/3110/2437/ASBtoNAE%20FRS5240604.doc

not be wrong for tax computations in respect of these earlier periods to overlook the new way at viewing SSAP 9.

However, for accounting periods that end after 21st June 2005, it will be obligatory for accounting purposes to comply with SSAP 9 as reinforced by UITF 40. The calculation of profits for tax purposes must be made on the same basis.[16] Debates concerning the original purpose and scope of SSAP 9, FRS 5 and Application Note G are now therefore sterile. The accountancy profession has declared (as is its right) that the long-term contract provisions in SSAP 9 apply to many more contacts than was previously thought to be the case. The tax calculations must now follow suit. As Mike Truman said in his own article:

> *... if HMRC take a case to court to establish what GAAP is in this area, there is virtual unanimity from the accounting side of the profession. We do not have to like it to accept that it is GAAP.*

Practical considerations - examples

It is now apparent that many contracts will need to recognise a profit in accounting periods earlier than was previously the general practice. The situations in which this is the case (and the amount of the profit that must be so accelerated) are subject to the guidance in SSAP 9.

I have previously suggested that a tax adviser who prepares tax returns must bring in some work-in-progress (at sale price rather than cost) at the accounting date even if no right to consideration has been created. The goal of SSAP 9 is to ensure that the attributable (proportion of) profit (as calculated on a prudent basis) is reflected in the accounts. To achieve this, the accounts must reflect as turnover the appropriate proportion of the contract value and the costs that are to be matched with this turnover so that the net profit shows the proportion of work completed. A similar result would arise in relation to most professional firms' compliance work of an equivalent nature.

Conversely, SSAP 9 does not allow profits to be recognised if the outcome of a contract cannot be assessed with reasonable certainty. A good example is

16 It might be arguable that this was not always the case. Prior to the Finance Act 2002 obtaining Royal Assent on 24 July 2002, the original words in section 42 of the Finance Act 1998 required profits to be calculated on a true and fair basis. Non-compliance with SSAP 9 gives rise to a risk therefore that profits were (in many cases) wrongly calculated for tax purposes. However, in most cases (i.e. except where a return is particularly late), taxpayers would not be exposed to a possible discovery assessment as the previous non-compliance with SSAP 9 would be "in accordance with the practice generally prevailing at the time" (as provided for by section 29(2) of the Taxes Management Act 1970).

provided by the Law Society's Guidance on UITF 40[17]. That example concerns a solicitor advising a client involved with litigation where the retainer is subject to a conditional fee agreement. At any stage where the outcome of the litigation is uncertain, it would be inappropriate for the fee to be recognised as income of the solicitor. However, once a favourable judgment is obtained, the basic fee and any uplift must be recognised as the outcome can now be assessed with reasonable certainty. It might be the case that the actual fee payable will be subject to later assessment and therefore it might not be able to be accurately quantified by the accounting date. However, this is not a bar to the income being recognised; any uncertainty in the quantification must be reflected in assessing how much of the income should be brought into account – SSAP 9 requiring the profits to be calculated on a prudent basis.

Practical considerations – timing of tax liabilities

When a firm first adopts the accounting treatment made mandatory by UITF 40, it will undoubtedly see an acceleration of income recognition. This will, in most cases, give rise to a sudden increase in the proprietors' tax bills.

For accounting periods ending before 22nd June 2005, firms can decide not to adhere to UITF 40 – even though earlier compliance with the abstract is encouraged. For later accounting periods, compliance is obligatory. Therefore, many firms will be first required to bring in a large element of the work-in-progress in their 2005/06 accounts (with the consequent increase in their tax bills first hitting on 31st January 2007). For firms with accounting dates between 6 April and 21st June, the impact will be deferred until the 2006/07 year of assessment tax thereon due on 31st January 2008.[18]

There have also been calls for a reintroduction of the spreading rules to ease the cash flow burdens that might follow. As at the date of writing, the Government has made no suggestion that it would accede to these requests.

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17 See http://www.lawsociety.org.uk/secure/file/139945/d:/teamsite-deployed/documents// templatedata/Internet%20Documents/Non-government%20proposals/Documents/ revrecoglawsocsummary050505.pdf.

18 Of course, the effective impact of this increase in assessable profits could be felt a year earlier because of the need to make payments on account.