

Statement of Recommended Practice for Disclosure of Guernsey Income Tax Provisions in the Financial Statements of Guernsey Businesses.

This statement is intended to provide guidance for disclosure in accounting periods ending in 2004 and 2005 prior to the change to tax business income on a current year basis in 2006.

The proposals to change the taxation of businesses were laid before the States and approved on 29 September 2004. The Projet de Loi was published in November and passed on 24 November 2004. By virtue of the Taxes & Duties (Provisional Effect) (Guernsey) Law 1992, the effective date is 1 January 2006 with the transitional provisions becoming effective from 1 January 2005. Detailed regulations will not however be available until some time next year. This guidance is effective immediately.

The Guernsey tax treatment of income from businesses will be moving from a prior year basis, which applies up to and including the Year of Charge 2004, to an actual basis, which will apply from and including the Year of Charge 2006. The Year of Charge 2005 will therefore be a transitional year and assessments will be based on the average of the tax adjusted profits for the accounting periods ending in 2004 and 2005. This statement has been prepared to provide guidance to Guernsey businesses in accounting for the tax charge and making disclosure in the financial statements of those businesses affected by the transitional provisions and to encourage consistency amongst businesses affected by the change.

Do the transitional rules apply?

The transitional rules will not apply to businesses that commenced to trade between 2nd January 2003 and 31 December 2004, and will not apply to businesses that intend to cease trading between 1 January 2004 and 31 December 2006.

Where there is a commencement or cessation in either of the periods stated, the transitional rules will not apply and tax should be provided in the financial statements on a consistent basis in accordance with the previous practice.

Tax treatment where the transitional rules apply:

Accounting period ending in 2004

Income tax should be provided for the Year of Charge 2005 at 10% of the tax adjusted profits shown in the accounting period ended in 2004.

Annual allowances may be claimed for the Year of Charge 2005 based on the tax written down value brought forward at the end of the Year of Charge 2004 together with additions/disposals in the accounting period ending in 2004.

Accounting period ending in 2005

Income tax should be provided for the Year of Charge 2005 at 10% of the tax adjusted profits shown in the accounting period ended in 2005.

Annual Allowances for the Year of Charge 2005 should be recomputed based on the tax written down value as at the end of the Year of Charge 2004 together with additions/disposals in both the accounting periods ending in 2004 and 2005. (This adjustment will usually be fairly limited as most of the allowances will already have been taken into account in the tax provision for the accounting period ending in 2004).

Example:

A business which commenced some years ago prepares accounts showing the following tax-adjusted profits:

Year ended 30 June 2003 £25,000
Year ended 30 June 2004 £28,000
Year ended 30 June 2005 £30,000
Year ended 30 June 2006 £33,000

The tax assessments will be:

Year of Charge 2004

(year ended 30 June 2003) £25,000

Year of Charge 2005

(average of tax-adjusted profits for the year ended 30 June 2004
and year ended 30 June 2005)

(i.e. (£28,000+£30,000)/2) £29,000

Year of Charge 2006

(year ended 30 June 2006) £33,000

Annual allowances

Annual allowances are given for a Year of Charge on the basis of activity in the basis period which will be generally be the company's accounting period of 12 months. The basis period will alter however when businesses commence or cease, or change their accounting year end but only one set of annual allowances will be given for each Year of Charge even though two sets of depreciation may be charged in the business accounts. This will have deferred tax implications and appropriate disclosure should be made in the deferred tax note. The basis period for annual allowances granted in the Year of Charge 2005 will equate to the entire period covered by the accounting periods ending in 2004 and 2005 and the calculations should incorporate any additions or disposals of assets in that period.

Exceptional cases

There will be some exceptional cases where the transitional rules will produce a tax charge that will be considered an “inequitable result”. The billet says that legislation will be enacted to cover such cases but no details are yet available. Usually this would occur where there are losses in either 2004 or 2005 and if this is the case (and in the continued absence of specific rules to deal with this situation) it is recommended that the matter is discussed with your usual tax advisor or the Tax Office to agree the quantum of the charge in the transitional year on an equitable basis.

Aggregate loss claims

We have, however, been advised by the tax office that where the 2004 accounts show a tax adjusted loss aggregate loss claims are still possible. However any loss allowed under these provisions would be deducted from the transitional loss as follows:

Accounts to 31 December 2004 – tax adjusted loss £(5,000)

Accounts to 31 December 2005 – tax adjusted loss £(9,000)

Therefore the transitional loss for the Year of Charge 2005 would be £(7,000) but if an aggregate loss of £(5,000) has already been claimed then the transitional loss figure would be reduced to £(2,000). In some cases this could result in a minus figure thus producing assessable profits for the Year of Charge 2005.

Assessments for the Year of Charge 2005

As accounts ending in 2005 will be required before finalising assessments for the Year of Charge 2005, we understand from the tax office that provisional assessments will be made based on accounts ending in 2004. Appeals against estimated assessments for the Year of Charge 2005 will be determined once the 2005 accounts are received by the tax office. Appeals against estimated assessments will not be listed for hearing until September 2007 (one year later than usual). Therefore the majority of assessments for 2005 including business profits should be regarded as provisional. However tax should be paid as normal.

Businesses where the 2004 accounts have already been finalised with a full 20% tax charge

As the changes were only published recently there will be cases where the 2004 accounts have already been finalised with a full tax charge being computed under the existing rules. Where that is the case then the appropriate adjustments should be made in the 2005 accounts. This may mean that there is a negative tax charge in the 2005 accounts.

Recommended note disclosure for Companies (note this wording can be used for all types of businesses)

The basis of assessment of trading income to Guernsey tax is changing from a prior year basis to a current basis from 2006. The trading profits shown in these accounts are subject to transitional provisions under the Taxes & Duties (Provisional Effect)(Guernsey) Law 1992.

The profits chargeable to tax for the Year of Charge 2005 will be the average of the adjusted profits for the 2004 and 2005 accounting periods.

Previously the company accrued for current tax based on the taxable profit (or loss) for that accounting period notwithstanding that tax was charged to the Company on a prior year basis. The accounting impact of the transition to an actual basis from 2006 is that only half of the year's profits for 2004 and 2005 year ends will suffer tax at 20%.

To normalise the impact of the transition, the Company is no longer accruing current tax on a prior year basis and, for 2004 and 2005 year ends, is providing for tax at 10% on the taxable profits arising in those years.

With effect from the 2006 year end the Company will make full provision for tax, based on the tax rate applicable to the Company, on its current year taxable profits.

Profit before tax	XXX
Effective tax charge at 20%	XX
Effect of transitional provisions	<u>(XX)</u>
Current tax charge	XX