As specialist medical accountants we meet regularly with GPs and practice managers who are confused about how the practice accounts relate to the partners’ tax bills. Frequently we are asked why a change in profits takes so long to be reflected in a tax bill. We come across doctors and practice managers who are perplexed by personal expenditure statements; how do they tie in with the partnership accounts and the partners’ individual tax returns? And even experienced GPs are baffled by the calculation of pensionable profits and ask us why they do not equal either accounts or taxable profits.

With this special edition we hope to guide you through the maze by explaining:

• What is your accounting profit
• Why it differs from taxable and superannuable profits
• Why you feel like you never see the profits earned!
• What, why and when you need to provide what can seem an inexhaustible jumble of information to your accountants.

“Why has my tax bill gone up? I don’t feel like I’m earning any more money!”

“Why have we just received a bill for underpaid superannuation?”

“Do I pay tax on my drawings?”

“When do I actually pay tax on my earnings?”

* Practice managers: keep a copy of this helpsheet handy. It could provide some useful answers for a puzzled GP.
Why accruals count
Understanding the accruals basis is key to understanding the practice accounts. Take, for example, income from the QOF. In preparing accounts for the year ended 31 March 2012 an accountant will bring into account the QOF income actually earned during that year, even though the final achievement payment will not have been received.

To understand why, look at a GP partner retiring at 31 March. He or she would have contributed to the efforts required to earn the QOF income and consequently it would be unfair if the GP did not take a share of the income. Similarly, if the QOF achievement money was treated on a received rather than an accrued basis, a new partner joining the practice on 1 April would not have contributed anything to earning the QOF income yet would, unfairly, share in the money.

With the accruals basis of accounting there is always likely to be income earned but not received and expenditure incurred but not paid. This is one of the main reasons for including a balance sheet within the partnership accounts.

Partners’ accounts
There can be confusion about the elements that make up the partners’ capital and current accounts (see ‘Glossary’) which form part of the balance sheet. In essence the capital accounts tend to represent the net equity in the property held by the partners and other funds invested in the assets of the business plus working capital. The current accounts represent profits not yet withdrawn by the partners.

Distinctions between capital and current accounts can blur, for example when there is an overdraft secured on the partnership property that fluctuates significantly. In this case it would be difficult to determine what proportion of the overdraft, if any, relates to financing the property as opposed to the partnership’s business operations.

And to add to the confusion, sometimes working capital is included in the partners’ current accounts and not capital accounts.

The difference between profits and drawings
Profits are made when the practice charges more for its services than it costs to provide those services. This is quite a natural function of self-employment. In a simple extreme, the receipt of payment for the service and the expenditure itself would happen on the same day, and so any funds generated would be available for the partners to withdraw; sadly however, that rarely happens in GP practices. For instance, the QOF “achievement” receipt may come in many months after staff have been paid for their efforts in generating the points. For this reason, partners’ drawings may be made in advance or arrears of the profits themselves. Any undrawn profits sit in partners’ current accounts available for withdrawal when funds permit.

Importantly though, tax is calculated based on when the profits are earned by the practice. The amount of drawings is irrelevant for tax purposes.
Statements of professional income and expenditure

What are they?
Separate from the partnership accounts, these statements list the total income and expenditure for individual partners. Statements of professional expenditure allocated to individual partners must be included in the partnership tax return and follow the same accounting period as the partnership accounts. Statements of professional income can either coincide with the partnership accounting year or coincide with the 5 April tax year-end.

Why are they needed?
GP partners often have items of income and expenditure that do not relate to the partnership or that are sufficiently different from the other partners to require separate treatment.

Examples
Partner A chooses to run an expensive car while Partner B is more frugal. It would be unfair for Partner B to bear a share of Partner A’s costs. Their motor expenses are included on the statement of the professional expenses, not in the partnership accounts.

Partner A undertakes a lot of out-of-hours work. This income can either be paid into the practice by the provider and “prior shared” to Partner A, or paid direct to Partner A. In the latter case this income will appear on the statement of professional income for Partner A.

Partnership tax returns

In the first instance the partnership tax return is prepared on the basis of the practice’s chosen accounting period (see “Taxation”). The overall figure for partnership profits subject to tax will rarely be the same as that shown in the accounts. This can confuse GPs, particularly the partner who has responsibility for signing off the partnership tax return. There are a number of reasons for the confusion:

• Some expenditure incurred by the partnership may not be allowable for tax – e.g. legal costs in preparing a partnership agreement.
• HMRC may allow or require practices to write off some larger assets at a higher or lower rate than those applied in the accounts. For example, a computer bought for £1,000 and expected to last four years will, in very simple terms, be written off by the accountant (“depreciated”) against profits at £250 a year. Sometimes though, HMRC has allowances in place enabling the whole amount to be claimed in the first year. Conversely HMRC can require the asset to be written off over a longer period than the accounts show.
• The partnership tax return incorporates the statements of professional expenditure for individual partners even though, for most practices, they are not reflected in the partnership’s profits.

Don’t put it off
The partnership tax return cannot be prepared until statements of professional expenditure have been gathered for all partners. Consequently one procrastinating partner can cause all the other partners’ tax affairs to be held up, since individual tax returns cannot be prepared until the partnership tax return is finalised.

Be accurate
It is important to note that if one of the partners is not properly declaring all income or is over-claiming expenditure (e.g. exaggerating the amount of business mileage) this affects the partnership tax return and provides HMRC with a reason to look into all the other partners’ tax affairs.
Personal income tax returns

The starting point for the tax return for an individual partner is usually their share of partnership profits (adjusted for statements of professional expenditure) as shown in the partnership tax return plus other income shown on the statement of professional income. This figure is then adjusted for other items such as bank interest, dividend income, profits or losses from property etc. Generally the adjusting items relate to investment income and/or non-medical business interests and pension contributions (see ‘Pensions’) although there can be exceptions.

Basis period explained

There is often confusion over the periods accountants set for income and expenses analysis. This is because HMRC uses a ‘basis period’ system to identify the profits taxable in any particular tax year. For partnership profits the basis period will usually be the partnership accounts year that ends in the tax year ended 5 April.

<table>
<thead>
<tr>
<th>Partnership accounts year-end</th>
<th>Tax year</th>
</tr>
</thead>
<tbody>
<tr>
<td>31 March 2012</td>
<td>2011/12</td>
</tr>
<tr>
<td>30 June 2012</td>
<td>2012/13</td>
</tr>
</tbody>
</table>

Having used the partnership accounts year as the basis period for partnership profits, HMRC treats non-medical and personal income such as bank interest and dividends differently. The basis period for income received for these items will be the tax year ending 5 April.

So unless the partnership has an accounting year-end of 31 March (which is accepted by HMRC as the simplification for the strict fiscal year-end of 5 April), a GP’s personal income and expenditure will be gathered for different periods.

Example

A GP partner with a partnership accounts year-end of 30 June will have a personal tax return for 2012/13 based on the partnership tax return, and statement of professional expenditure, for the year ended 30 June 2012; together with dividends and bank interest received for the tax year ended 5 April 2013.
Understanding there is much confusion surrounding payments for tax and the periods with which payments are associated. The main difference is due to whether practices have a 31 March year-end or some other date.

Illustrations
Partnerships with an accounts year-end of 31 March 2012: these accounts form the basis period for the tax year 2011/12, so payments on account are made in January 2012 and July 2012. These two payments on account are usually one half each of the preceding year’s liability. Because profits fluctuate this can lead to either a balancing payment, adjusted for in January 2013, or a tax refund. The total tax paid in January 2013 is consequently made up of two elements. The first is the initial payment on account for the 2012/13 tax year and the other is made around four months after the year-end. Assuming profits and other income have been relatively stable, this would deal with more or less all of the tax due. However, for practices with an accounts year not ending on 31 March, all of the tax payments are made after the year-end.

GPs about to retire should be aware of these implications since post-accounts year-end tax liabilities can come as a nasty surprise when tax payments have been made on account all through the doctor’s working life.

Changing the financial year-end date
For practices thinking that changing to a financial year-end of 31 March would make life easier - beware. While changing an accounts period can be a relatively straightforward process, the cash flow implications can be significant since tax payments are frequently brought forward. Even though no more profit is being earned the tax has to be paid earlier, which could put the practice under pressure financially.

Given the additional higher rate taxes now in force, a change in the accounting year could also trigger higher tax liabilities. There are also other complications such as bringing forward the use of income tax ‘overlap relief’, usually available to partners in practices with year-ends other than 31 March.

Pensions
For almost all GPs, pensionable (alternatively referred to as superannuable) profits do not equal either accounts profits or taxable profits. This is because pensionable profits under the NHS Pension Scheme are focused on NHS income only. Income generated from non-NHS activities, such as private medical examinations, cannot be included and GPs do not have to pay NHS Pension Scheme contributions on this income.

With some of a GP’s income ineligible for NHS superannuation, the NHS Pension Scheme also requires a proportion of expenditure to be ignored for the purposes of arriving at pensionable profits. These come together on the superannuation certificate, normally prepared by the accountant, and determine:

- How much is added to a GP’s career earnings, which are then directly linked to his or her eventual pension.
- How much the GP needs to pay in contributions. The rates are tiered, so an increase or decrease in pensionable profits can lead to a disproportionate rise or fall in contributions. Contributions are deducted from the practice funds but are allocated against the profits and drawings of the individual GP partners.

The practice makes monthly payments on account for superannuation contributions. These are based on estimates prepared by the practice or by the accountant and submitted to the NHS Shared Business Services in March of the preceding year. Superannuation contributions are not an expense of the business but they are deductible in arriving at taxable earnings; however because they are pension contributions not business expenses, they are eligible for tax relief in the tax year when they are paid, rather than in the chosen accounting year of the practice.

Timing
There are timing differences between accounts profits and pensionable profits, as the same basis period approach that HMRC operates is used. The NHS Pension Scheme superannuation certificate always runs to 31 March, but will be based on profits earned in the accounting period that ends in that year.

Superannuation certificates must be submitted to NHS Shared Business Services no later than the 28 February following the superannuation year-end. Any additional sums due for payment or refund are then adjusted for in the month after submission.

From the table below it is clear that there can be considerable delays between a change in profits and the consequent need for a balancing payment or refund for the related superannuation contributions.

<table>
<thead>
<tr>
<th>Partnership accounts year-end</th>
<th>Pensionable profits year-end</th>
<th>Superannuation certificate due</th>
<th>Balancing payment or refund made</th>
</tr>
</thead>
<tbody>
<tr>
<td>31 March 2012</td>
<td>31 March 2012</td>
<td>February 2013</td>
<td>March 2013</td>
</tr>
<tr>
<td>30 September 2012</td>
<td>31 March 2013</td>
<td>February 2014</td>
<td>March 2014</td>
</tr>
</tbody>
</table>
## Schedule of key dates

<table>
<thead>
<tr>
<th>Year-end Date</th>
<th>Year-end Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Practice accounts</td>
<td>Practice accounts</td>
</tr>
<tr>
<td>31 March 2012</td>
<td>30 September 2012</td>
</tr>
<tr>
<td>Partnership tax return - strict filing deadline</td>
<td>Partnership tax return - strict filing deadline</td>
</tr>
<tr>
<td>31 January 2013</td>
<td>31 January 2014</td>
</tr>
<tr>
<td>Partnership tax return - aim to complete in</td>
<td>Partnership tax return - aim to complete in</td>
</tr>
<tr>
<td>September 2012</td>
<td>June 2013</td>
</tr>
<tr>
<td>Statement of professional income and expenditure - aim to send to accountants in</td>
<td>Statement of professional income and expenditure - aim to send to accountants in</td>
</tr>
<tr>
<td>August 2012</td>
<td>December 2012</td>
</tr>
<tr>
<td>Personal tax information (non-business related) - e.g. dividends or interest received, property rentals other than the surgery</td>
<td>Personal tax information (non-business related) - e.g. dividends or interest received, property rentals other than the surgery</td>
</tr>
<tr>
<td>Convenient to send in with statements of professional expenditure above – August 2012</td>
<td>3 to 4 months after end of tax year, so June / July 2013 for 2012/13 tax year</td>
</tr>
<tr>
<td>First tax payment on account</td>
<td>First tax payment on account</td>
</tr>
<tr>
<td>31 January 2012</td>
<td>31 January 2013</td>
</tr>
<tr>
<td>Second tax payment on account</td>
<td>Second tax payment on account</td>
</tr>
<tr>
<td>31 July 2012</td>
<td>31 July 2013</td>
</tr>
<tr>
<td>Balancing tax payment</td>
<td>Balancing tax payment</td>
</tr>
<tr>
<td>31 January 2013</td>
<td>31 January 2014</td>
</tr>
<tr>
<td>Superannuation certificate to be submitted</td>
<td>Superannuation certificate to be submitted</td>
</tr>
<tr>
<td>28 February 2013</td>
<td>28 February 2014</td>
</tr>
</tbody>
</table>

## Conclusion

Managing a practice’s accounts, tax and pension requirements is a complex business and the involved sets of rules surrounding timings are not easy to grasp. You should always take advice from your accountant and at Francis Clark we would be very pleased to help clarify any of the information set out in this helpsheet.