

Preparation of Accounts for Revenue Purposes Treatment of Debtors, Creditors and Work-in-Progress in Professional Accounts

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1. Introduction

Accounts prepared on a basis other than the earnings basis have been accepted by the Revenue Commissioners over the years for the purpose of determining the profits for tax purposes of some individuals and partnerships carrying on professions.

During the course of examination of these accounts it has come to notice that some accounts are prepared on a basis that is not acceptable to the Revenue Commissioners. These accounts are prepared on varying bases which do not provide an orderly and consistent framework for determining profits. In particular, the matching of costs with related income can fall significantly out of line, in certain circumstances.

This manual sets out the basis on which accounts may be drawn up for tax purposes in the case of an individual or partnership carrying on a profession.

It does not, however, apply to an individual carrying on a profession as a barrister, because of the particular arrangements that apply to the payment of fees in that profession. Barristers may, of course, compute their profits on an earnings basis if they so wish. However, once this option is taken it cannot normally be changed subsequently except on the basis outlined in paragraph 3.5 below.

2. Bases on which accounts, acceptable to Revenue, may be prepared

The Revenue Commissioners consider that the “earnings basis” is the strictly legal basis for drawing up accounts for tax purposes. “Earnings basis” is defined in section 91(5)(a) of the Taxes Consolidation Act 1997 (see Appendix) and this basis is acceptable in all circumstances.

This basis would in all cases take both debtors and creditors into account. Work-in-Progress would also be included where normal accountancy principles would require that it be taken into account.

All companies are required to prepare accounts on this basis as are individuals and partnerships carrying on trades (other than certain farmers).

In the case of an individual or partnership carrying on a profession it has, over the years, been the practice of the Revenue Commissioners to accept accounts prepared on a basis other than the earnings basis. Such a basis is referred to as a “conventional basis” and includes a “cash basis” as well as anything between a full earnings basis and a simple cash basis.

It is in relation to accounts prepared on a conventional basis that the problem mentioned in paragraph 1.1 above arises.

This manual clarifies the circumstances under which accounts prepared on a conventional basis are acceptable for tax purposes.

3. Rules governing the use of a Conventional Basis

3.1 Commencements

Where a profession commences to be carried on by an individual or is treated by section 66 of the Taxes Consolidation Act 1997 as commencing to be carried on or a relevant period (as defined in section 1007 of that Act) in relation to a profession carried on in partnership commences, the accounts for the first three years from the date of commencement must be prepared on an earnings basis.

3.2 Ongoing

Subject to paragraph 3.1, where it has been the practice in the case of an individual or partnership to prepare accounts on a conventional basis, the Revenue Commissioners will continue to accept accounts prepared on that basis provided the following conditions are met:

- (i) the profits computed on the conventional basis will not, taking one year with another, differ materially from what the profits would be if a full earnings basis were used,
- (ii) bills for services rendered or work done are issued at regular and frequent intervals and
- (iii) precise details of the basis used appears as a note to the accounts.

For a conventional basis to be acceptable, it should normally include debtors and creditors. Work-in-Progress need only be included in cases where its exclusion would materially affect the annual taxable profits.

A provision for specific doubtful debts made in accordance with standard accountancy principles is allowable for tax purposes. The Revenue Commissioners will accept that a proportion of longstanding small debts is a specific provision for tax purposes - provided the amount can be justified by reference to previous experience in that practice.

Where accounts are prepared on a basis other than an earnings basis, the onus lies with the taxpayer to prove that the conditions outlined above have been met.

3.5 Change in Basis

At some time after the expiry of three years from commencement, a taxpayer may change to an appropriate conventional basis which meets the conditions of paragraph 3.2. Such a change, however, must be complete.

Thus, where there is a change to a conventional basis, that basis must be applied without regard to the fact that some amounts which are required to be taken into account after the change may have already been credited in a previous income account.

3.7 Cessations

Cessation includes a deemed cessation under section 67 of the Taxes Consolidation Act 1997. It also includes the case of a partner leaving a partnership, although the relevant period does not cease in relation to the partnership.

Where an individual ceases to carry on a profession and amounts which have not been assessed to tax in a subsequent year of assessment, the Revenue Commissioners will, on receipt of a claim to this effect, treat such deferred amounts as post cessation receipts chargeable to tax under the provisions of section 91 of the Taxes Consolidation Act 1997 for the years of assessment in which these would have been assessed if the cessation had not occurred. Otherwise, these amounts must be brought into charge to tax in the final year of assessment for which the person is assessed to tax in respect of that profession.

4. Expressions of Doubt

The provisions of section 959P of the Taxes Consolidation Act 1997 relating to expressions of doubt may be used where there is a doubt as to whether the basis adopted in any particular case complies with this manual.

The circumstances under which liability might arise under Chapter 7 of Part 4 of the Taxes Consolidation Act 1997 in a case where a conventional basis is used are unaffected by the foregoing.

Appendix

Section 91(5)(a) of the Taxes Consolidation Act 1997

“...the profits or gains of a trade or profession in any period shall be treated as computed by reference to earnings where all credits and liabilities accruing during that period as a consequence of the carrying on of the trade or profession are taken into account in computing those profits or gains for tax purposes, and not otherwise, and "earnings basis" shall be construed accordingly”