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Basis period reform will impact buisness income tax self-assessment

In the 2021 Autumn Budget, the government confirmed their plans for basis period reform which will change the rules that decide when income is taxed for businesses, including the self-employed, partnerships and trusts.

The tax year runs to 5 April every year, and for those who draw up their accounts to this date or to 31 March, calculating the basis period for tax is straightforward as it aligns with the tax year. However, for those who draw up their accounts to a different date, there is currently a 'basis period' set of rules to calculate what and when the profits are taxed. These can be complex, and can mean that some profits are taxed twice in the early years of trading where the basis periods overlaps the tax year. These profits are then carried forward as 'overlap relief' to be relieved when the trade ceases or the accounting date changes.

In an effort to simplify this, the government has decided to replace these rules with a regime that calculates business profits or losses for a tax year as arising in the tax year. The changes were planned to take effect in 2024, ahead of the mandation of Making Tax Digital for income tax (MTD ITSA), which will require quarterly reporting of tax data to HM Revenue & Customs (HMRC). This is on the basis that aligning the reporting of business profits and losses to the tax year will make MTD reporting easier.

The implementation of MTD ITSA has been pushed back to April 2026 (and later for some taxpayers), but the basis period reforms will still go ahead from 6 April 2024, with a transitional year in the tax year commencing 6 April 2023. Taxpayers will, therefore, have longer to adjust to the impacts of basis period reform before needing to be MTD-ready.

How will profits be apportioned?

Under the new basis period rules, businesses will still be able to choose their accounting date, but for tax purposes they will need to apportion their profits and losses into each tax year. The new rules state that apportionment will be on a time basis. This will be an additional administrative step for businesses, and may be difficult for businesses with fluctuating profits. Although the new rules allow an alternative apportionment method to be used (if the method is both reasonable and applied consistently), this will be subject to challenge by HMRC. As part of this simplification, an accounting date between 31 March and 5 April will be deemed to be equivalent to 5 April, to prevent businesses from having to apportion only a few days of their profit or loss across two tax years.

For businesses whose accounting date is later in the year, they are unlikely to have profit figures available to apportion before the filing deadline for income tax. Under the new rules, these businesses will have to file their returns using provisional figures and then amend their returns once the final profit or loss figures are known. This will cause an additional administrative burden for, and while HMRC states that this can be resolved by changing accounting date, this may not be possible for many.

How will the transition work?

A move to the tax year basis will potentially bring forward tax liabilities for some businesses. The new rules include a one-year transition period in the year commencing 6 April 2023. In this year, taxpayers will be taxed on their profits for the 12 months starting from the end of the last basis period falling within the 2022-23 tax year, and then an additional 'transition' component running from the end of that period to 5 April 2024. To ease the burden, the 'transition' profits will be automatically spread over five years, with the taxpayer being able to elect to bring forward some or all of those profits if they wish. Alongside this, any overlap relief outstanding from the opening years of trade will need to be used in the transition period – none will be carried forward or generated in the future.

Change of accounting date

The government consultation document that preceded these new rules assumed that many businesses affected by the change would alter their accounting date to match the tax year, in order to reduce the impact of the changes. However, this is not practical for many businesses whose accounting date is commercially driven, and the new rules raise some complex questions about how these businesses would identify the relevant profits. This was one of the issues which came up repeatedly in responses to the original consultation, and the government now plans to relax its guidance on how soon final figures for relevant profits can be submitted, in order to reduce the burden on affected businesses.

If you have any questions about what these changes might mean for you and your business, please get in touch with your usual Saffery contact or get in touch with:

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