Basis Period Reform
Clauses 7-8 and Schedule 1

Executive Summary

We welcome the government's deferral of the start date for basis period reform until 2023/24. This should allow for more consultation on some aspects of the rules, greater understanding of the wider impacts of the change (including the interaction with Making Tax Digital for Income Tax Self-Assessment), and a longer lead in time to allow businesses, agents and HMRC sufficient time to prepare.

We are concerned that the measure replaces the complexities of the current regime with different (and potentially greater) complexities for the minority of businesses for which there are commercial obstacles to adopting a tax year accounting period end and that these complexities will arise on an ongoing basis meaning that costs and administrative burdens for those businesses will increase permanently as a result.

The new rules will require such affected businesses to submit tax returns every year containing provisional (estimated) figures. We welcome that the government has committed to exploring how the burden of doing this might be eased. This exercise should be undertaken in a transparent manner as a public consultation.

It is important that the changes and their impact are communicated clearly in advance to businesses which will be affected by the transition to the new rules.

1. Overview

1.1. Clause 7 and Schedule 1 abolish basis periods for unincorporated trades (including professions and vocations) for the tax year 2024/25 and subsequent years and provide transitional rules for the tax year 2023/24. The measure affects self-employed sole traders and partners in partnerships.

1.2. The government's policy objective for the proposal is to create a simpler, fairer and more transparent set of rules for the allocation of trading income to tax years[1].

[1] https://www.gov.uk/government/publications/basis-period-reform/basis-period-reform

1.3. The existing basis period for a tax year is called the 'current year basis'[2]. A business is taxed by reference to the profits or losses shown by the annual accounts ended in the relevant tax year. There are specific rules that apply in the opening years of a trade which can create overlapping basis periods when tax is charged on profits twice if a business chooses an accounting date that is not aligned with the end of the tax year (ie 5 April)[3]. This generates 'overlap relief' which is usually given when the business ceases to trade, but also on a change of accounting date.

1.4. The reform changes the way profits and losses are taxed to a 'tax year basis'. A business's profit or loss for a tax year will be the profit or loss arising in the tax year itself, regardless of the business's accounting date. This will prevent the creation of future overlap relief. On transition to the tax year basis in the tax year 2022/23, all businesses' basis periods will be aligned to the tax year and all outstanding overlap relief given.

1.5. As part of the reforms, 31 March and the following four days will be deemed as equivalent to 5 April to prevent businesses with accounting dates between 31 March and 5 April having to apportion small amounts of profit.

1.6. The majority of businesses will be unaffected by these proposals[4] as they already draw up accounts to a date that is aligned (or will be treated as aligned) with the tax year. Therefore, our comments are directed towards the impact on businesses that do not draw up accounts to 31 March / 5 April (referred to as 'affected businesses'), and those who advise them. We understand that this represents some 528,000 individual taxpayers.

1.7. The Exchequer impact[5] is estimated to be £1.7bn between 2023/24 and 2026/27. The costing which has been certified by the Office of Budget Responsibility (OBR) has two main components:

- The yield associated with the additional profit generated during the transitional period (spread over five years); and
- The loss in revenue generated by taxpayers deducting overlap relief during the transitional period.

The main uncertainties in this costing relate to the total value of historic overlap relief available to taxpayers during the transition period[6].

1.8. There will be further impacts over the following two years so the overall impact could be over £2bn (though the impact beyond 2026/27 has not been estimated by the government or OBR). However these Exchequer impacts are largely a timing effect as the additional tax liabilities in the transitional tax year would have been due in future years under the old system if the sole traders and partners changed their basis period or ceased trading. The measure represents a

---

[2] The current law on basis periods is in Chapter 15 Part 2 ITTOIA 2005.

[3] There are also special rules for opening years which deem accounts prepared to 31 March – 4 April to be treated as prepared to 5 April.

[4] The consultation into basis period reform, which took place in August 2021, stated that 93% of sole traders and 67% of partnerships will be unaffected by these proposals.

[5] Summary of Impacts - see https://www.gov.uk/government/publications/basis-period-reform/basis-period-reform#detailed-proposal.

[6] See page 58 – Autumn Budget 2021 Policy Costings https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1029980/Policy_Costings_Document_FINAL.pdf

significant one-off 'windfall' in the short term but is broadly revenue neutral over the long term.

1.9. Affected businesses will need to apportion their profits to the relevant tax year, making estimates where actual figures are not available by the time they need to submit their self-assessment tax return to HMRC - which will then need to be amended at a later date. This is a permanent change which affected businesses will have to do every year not just in year one of the reform.

1.10. It is likely that some affected businesses will decide to change their accounting year end date so as to coincide with the tax year or 31 March because of this reform.

1.11. However, there will be businesses for which it will be inconvenient, undesirable or impossible to adopt a tax year end accounting date.

1.12. The tax year 2023/24 will be a transitional year as businesses move from the 'current year basis' to the 'tax year basis' of taxation[7]. The basis period for the year will be the 12 months from the end of the basis period from 2022/23, plus a transition component running from the end of this 12 months to 5 April 2024. Any overlap profits brought forward will be relieved in full in 2023/24 and not carried forward into the tax year basis.

1.13. For businesses with higher profits in 2023/24 due to the change in basis, the additional profits will be automatically spread over a period of five years.

1.14. Clause 8 allows property businesses to treat profits of a year to a date near to the end of the tax year (usually 31 March) as being equivalent to the profits of the tax year and applies for the tax year 2023/24 onwards. This is a sensible change and we have no other comments to make about it.

2. CIOT Comments

2.1. We welcome the fact that the government has deferred the start date for basis period reform by one year so it will not come into effect until the tax year 2023/24. This is something we called for in our letter to the then Financial Secretary in August.[8]

2.2. This deferral should allow for more consultation on some aspects of the rules, greater understanding of the wider impacts of the change (including the interaction with Making Tax Digital for Income Tax Self-Assessment (MTD for ITSA)), and a longer lead in time to allow businesses, agents and HMRC sufficient time to prepare.

2.3. However, we remain concerned that changes to what has been described as the 'fundamental building blocks of the tax system'[9] are being rushed through to facilitate the introduction of Making Tax Digital for Income Tax in April 2024.

---

[7] Para 65 Schedule 1

[8] See https://www.tax.org.uk/basis-period-reform-and-mtd-ciot-letter-to-financial-secretary-to-the-treasury

[9] See https://www.gov.uk/government/consultations/basis-period-reform/basis-period-reform-consultation, section 'Foreword'.

2.4. We are concerned that for affected businesses basis period reform will replace largely one-off complexities with ongoing ones and will not provide the desired simplification if these businesses are unable to change their accounting date to 31 March or 5 April. Administrative burdens and costs for these affected businesses will be increased as a result.

2.5. HMRC's impact assessment[10] recognises that there will be one-off costs for businesses including familiarisation with the rules, updating software, and deciding whether to change their accounting date to 31 March or 5 April. However, the estimated cost of this is considered to be 'negligible', which we think is unrealistic.

Costs and compliance aspects

2.6. The continuing annual costs of operating on the 'tax year basis' are estimated in HMRC's Policy Paper[11] to be £9.1m; this will be mainly the additional compliance involved for those businesses for which it will not be commercially practical or possible to change their existing accounting date, which we think underestimates the true ongoing costs[12]. However, the ongoing savings are estimated to be £10.2m, meaning that the overall impact is predicted to be a £1.1m *saving* in administrative costs for affected businesses. We find this hard to believe. It does not seem credible to us that the additional ongoing compliance and administrative burdens that affected businesses will suffer to comply with the new rules will be outweighed by savings elsewhere.

2.7. Whilst under existing rules there are some complications in the opening and closing years of a business, or when it changes its commercial accounting period end, these arise only at those specific points in a business's life and will mainly affect the minority of businesses that do not use the tax year as their accounting period end.

2.8. Under the new rules there will be continuing compliance issues for affected businesses around the need to apportion the results of two commercial accounting periods into each tax year and estimating – and subsequently correcting - the results of the second of those commercial accounting years.

2.9. Some affected businesses may change their year end to the tax year (or 31 March) to avoid the compliance difficulties mentioned above. However some businesses, particularly those with international connections, like large professional partnerships, or seasonal businesses, like farmers and those in the leisure and tourism industry, may be practically unable to do this and will suffer those burdens.

Education and awareness

2.10. Evidence from HMRC suggests that 20% of businesses who do not use the tax year are unrepresented (ie they do not have access to professional tax advice). This includes approximately 75,000 sole traders[13]. It would probably be advisable for most of these

[10] https://www.gov.uk/government/publications/basis-period-reform/basis-period-reform#policy-objective – section 'Summary of Impacts'.

[11] https://www.gov.uk/government/publications/basis-period-reform/basis-period-reform#detailed-proposal at page 6.

[12] Even if half of taxpayers affected change their year end to align with the tax year, the ongoing annual costs of apportionment, estimation and correction work out at less than £35 per taxpayer (£9.1m / (528,000 / 2)).

[13] HMRC's evidence to the House of Lords Finance Bill Sub-Committee on 28 October 2021 at 11:42.

businesses to change their accounting period to align with the tax year (or 31 March) in order to avoid the additional complexity that will otherwise arise.

2.11. But this will only happen if they are aware of the impending change to the basis period rules and understand what the implications will be for their business, in order that they can make an informed decision whether to change their accounting period, or not, and when to change it.

2.12. We also note that there is a trap in the legislation for the unrepresented or poorly advised taxpayer in that if a business changes its accounting period to 5 April (or 31 March) before the transitional year 2023/24 they will not be able to spread their excess profits over five years, even though, by changing their accounting date, they might think they are doing what HMRC want them to do.

2.13. It is therefore essential that HMRC provide targeted and timely communications, guidance and support for this section of the taxpayer population in particular.

2.14. We also think that HMRC should establish a dedicated helpline to assist taxpayers and their agents with understanding the changes and providing support, including supplying figures for the amount of overlap relief taxpayers are entitled to.

Transition issues

2.15. The tax year 2023/24 will be a transitional year as businesses move from the 'current year basis' to the 'tax year basis' of taxation (see 1.10 above). For businesses with higher profits in 2023/24 due to the change in basis, the additional profits will be automatically spread over a period of five years.

2.16. There could have been numerous potential knock-on effects on an individual's total income arising from spreading the excess profits in the year of transition over five years - for example on the rate of income tax paid, loss of personal allowance, the High Income Child Benefit Charge (HICBC), superannuation, pension contributions, repayment of student loans and so on.

2.17. We noted in our response[14] to HMRC's recent consultation document that these kinds of issues would need addressing to prevent unfair outcomes and we welcome the fact that the government has decided to make some changes in the Finance Bill in response to issues raised during the consultation[15].

2.18. The changes that are in the Finance Bill[16] include treating any excess profits arising during the transition year as a one-off separate item of taxable income, rather than as part of a business's normal trading income. The government says that this treatment will minimise the impacts on

[14] https://assets-eu-01.kc-usercontent.com/220a4c02-94bf-019b-9bac-51cdc7bf0d99/b8a23a8a-d853-4bf7-bbbc-7db4d956e86c/210831%20Basis%20period%20reform%20-%20CIOT%20response.pdf

[15] https://www.gov.uk/government/consultations/basis-period-reform/outcome/summary-of-responses#next-steps

[16] Para 75 Schedule 1

allowances and means-tested benefits that were raised during the consultation, including by us[17].

2.19. The measure will minimise the impact of the excess profits arising in the transition year on the HICBC, pensions annual allowance and student loan repayments but it will not minimise the full impact on the tapering of the personal allowance in a situation where the excess profits cause a taxpayer's income to exceed £100,000. We understand that the legislation has been drafted in the way it has been to try to address as many as possible of the impacts that were raised as a concern during the consultation. While it still seems unfair that a taxpayer in that situation will end up paying more tax than they would otherwise have paid if the transition profits had not been brought into charge, it has to some extent been a balancing exercise to try to address these issues and at the same time minimise the incentive to manipulate the level of taxable profits if alternative solutions (such as taxing the transition profits as standalone income at a person's marginal rate of tax) had been used.

2.20. The government has also decided to extend the carry-back of loss relief arising due to excess overlap relief in the transition year from one to three years (where overlap relief creates a loss). This provides welcome flexibility around use of excess overlap relief for those taxpayers unable to benefit from full relief in the transitional year due to the level of their income, for example because they may be taking parental leave during the transitional year.

2.21. However, this flexibility with losses created by deducting overlap does not alleviate the potential to waste a person's tax free personal allowance caused by requiring the deduction of all overlap in full in 2023/24. For example, if a person has profits of £25,000 and overlap of £20,000 and no other taxable income, they will pay no tax as their taxable profits will be £5,000 and covered by their personal allowance (currently £12,570). The result is that, whilst they pay no tax, £7,570 of their personal allowance has not been used and the full benefit in tax terms of the overlap is not obtained.

Permanent Issues

2.22. Affected businesses will need to apportion their profits to the relevant tax year, making estimates where actual figures are not available by the time they need to submit their self-assessment tax return to HMRC - which will then need to be amended at a later date. This is a permanent change which affected businesses will have to do every year not just in year one of the reform.

2.23. The government has committed to exploring whether there are administrative or policy easements that can be introduced to minimise burdens caused by having to submit tax returns containing provisional / estimated figures. We welcome this commitment. We call on the government to undertake this exercise transparently as a public consultation. We look forward to engaging with HMRC in exploring what can be done to minimise such burdens.

Practical aspects

2.24. There is likely to be even greater bunching of work for businesses, agents and HMRC, as even more businesses will adopt a tax year (or 31 March) accounting period end, and MTD for ITSA

[17] Para 1.10 v. & vi. https://assets-eu-01.kc-usercontent.com/220a4c02-94bf-019b-9bac-51cdc7bf0d99/b8a23a8a-d853-4bf7-bbbc-7db4d956e86c/210831%20Basis%20period%20reform%20-%20CIOT%20response.pdf

quarterly reports will all be made based on calendar quarters. Also, if businesses move to a 31 March year end the VAT quarters may well also move to calendar quarters.

2.25. We suggest that to help ease the pressure, the deadline for submitting MTD quarterly reports should be extended from one month and five days to two months after the end of the relevant quarter. The government might also wish to consider a later ITSA filing deadline (eg 31 March rather than 31 January), and a later deadline for the MTD end of period update, either for affected businesses or across the board, in order to spread the workload and in part address the need for estimates in – and amendments to – returns.

3. The Chartered Institute of Taxation

3.1. The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

3.2. The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

3.3. The CIOT's 19,000 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

For further information please contact:
George Crozier, CIOT Head of External Relations
gcrozier@tax.org.uk
020 7340 0569

The Chartered Institute of Taxation
23 November 2021