Basis period reform: CIOT, LITRG and ATT responses

Management of taxes **OMB**

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The CIOT, LITRG and ATT are concerned that the pace of change required to implement HMRC's proposed basis period reforms ahead of the extension of Making Tax Digital (MTD) to income tax will place enormous pressure on businesses at a time when they are recovering from the pandemic. While the new rules may be a simplification for many, they also have the potential of introducing new complexities and burdens for businesses with a non-tax year end accounting period.

The CIOT, LITRG and ATT have responded to the proposal to change the rules under which profits of an unincorporated trading business are taxed, from a 'current year' basis (introduced with Self-Assessment in 1997) to a 'tax year' basis. In our responses, we raised concerns regarding:

- the proposed timetable for the change, recommending deferring it to allow time for greater consideration of the implications of the change, and potential complexities arising from the transitional year; and
- ongoing issues with the need for some individuals to estimate profits or losses and then amend their Income Tax Self-Assessment (ITSA) return.

The proposal

The proposal would set the tax year as the basis of assessment. Thus, businesses that already draw up their accounts to 5 April (or 31 March) would be unaffected by the change. Other businesses, with a non-tax year end accounting period, will have to apportion their profit or loss from two accounting periods to the specific tax year. For example, if accounts are drawn up to 31 December each year then for the 2024/ 25 tax year, the following would be assessed:

- 9/ 12 th of the profit or loss for the accounting period ended 31 December 2024; and

- 3/ 12 th of the profit or loss from the accounting period ended 31 December 2025.

One ‘simplification’ arising from this change would be that the current ‘opening years’, ‘closing years’ and ‘overlap profits/relief’ rules would no longer be required.

Interaction of basis period reforms and Making Tax Digital for Income Tax Self-Assessment

In addition to our individual responses to HMRC’s consultation, the CIOT, LITRG and ATT, along with other professional bodies, jointly wrote to the Financial Secretary to the Treasury, Rt Hon Jesse Norman MP, on 16 August. We expressed concerns that the timetable proposed for the introduction of the basis period change and the extension of MTD to Income Tax Self-Assessment would place enormous pressure on businesses and their advisers, as well as on HMRC.

We stated that these reforms are being implemented too quickly and will put the integrity of the tax system at risk. Further, the proposed changes to basis periods would come on top of the upcoming changes required by MTD for ITSA and the bringing of more small businesses into MTD for VAT (noting also that separate filings are required for VAT and ITSA), as well as changing penalty regimes, and other standalone digital process changes (e.g. CGT 30-day reporting).

We also said that while the basis period reform could bring simplification for some businesses, it would add complexity for others, particularly those with international connections who cannot change their accounting year end to 31 March/5 April. The change would also result in earlier payment of tax by many businesses when, in the post-COVID environment, many individuals are still finding their business incomes are fragile.

We therefore urged the government to reconsider urgently the timetable for the basis period and MTD ITSA proposals.

The joint professional bodies’ letter to the Financial Secretary to the Treasury can be found at www.tax.org.uk/fstbasisperiod.

Basis period consultation: CIOT response

As above, the CIOT’s main concern with the basis period proposal is the timing of the change, including:

- the additional financial and administrative burdens for affected businesses, at a time when we are emerging from a pandemic that has imposed huge pressures on businesses, their agents and HMRC;
- the extremely short timescales for consultation and implementation, which are likely to result in mistakes and unforeseen outcomes; and
- the wider tax administration environment that is already bringing, or proposing, significant further changes.

If the basis period change is implemented, then we considered that it would bring several downsides, including:

- For those businesses unable, or for which it would be inconvenient or undesirable, to adopt a tax year accounting period end, this would replace the complexities of the existing regime with different (and potentially greater) complexities of apportioning profits, and (for some) making estimates in ITSA returns.
- The need to make amendments to submitted returns will have the knock-on effect of extending the enquiry window for those returns and will increase the length of time before an affected taxpayer can have certainty over their tax affairs for the year.
- Where an affected business does not change its accounting period end to align with the tax year, its ITSA return will include time-apportioned figures from two accounting periods. It is unclear what impact this might have on HMRC's ability to enquire into the tax return because, unlike currently, the return will not include figures from accounts for just one period.
- There will be likely bunching of work for businesses, agents and HMRC, as even more businesses will adopt a tax year (or equivalent) accounting period end, and MTD for ITSA quarterly reports will all be made based on calendar quarters. We suggested extended deadlines to help address these pressures.
- The impact of excess profits in the year of transition, and spreading over five years on an individual's total income, will have cash-flow implications for some affected businesses. There will also be the knock-on effects from the loss of personal allowance, the High-Income Child Benefit Charge (HICBC), pension contributions, etc.
- There is the potential for excess profits from the transitional year to be taxed at much higher income tax rates than would be normal, even if the excess profit is spread over five years.

- The proposal to allow overlap relief brought forward to be deducted in full in the transitional year also raises some issues, including:
  i. In some cases, a business may not know the amount of its overlap profits as the information may have been 'lost' due to the passage of time since they arose. The business will need to rely on HMRC to provide it with the figure.
  ii. Since overlap is not index-linked and in many cases will have arisen many years ago, the value of it is likely to be very low compared to the (more than 12 months) profits arising in the transitional year, meaning that for some affected businesses the excess profits in the year of transition will be significant.

In our response, we also outlined specific issues with the proposals that require further consideration, including capital allowances, loss claims, payments on account, double taxation relief, NICs, student loan repayments, tax credits and pension contributions.

The CIOT response can be found at www.tax.org.uk/ref823.

Basis period consultation: LITRG response

We supported the general principle of these new proposals, as they mean complicated rules around basis periods become obsolete; and tax for the self-employed (including partners) will be based on profits in the tax year, which we think would be easier for unrepresented taxpayers to understand. We also noted that one of the main impacts of this change is likely to be to encourage new businesses to choose either 31 March or 5 April as their accounting date, which we support as we believe this would also help those who are newly self-employed to have a better overall understanding of their tax affairs.
We strongly recommended that the basis period change should be given time to be fully and properly implemented before MTD for ITSA begins, and therefore that serious consideration must be given to delaying the start date for MTD for ITSA.

We had two main concerns with the transitional provisions:

- We are concerned about the level of understanding there will be among unrepresented taxpayers of what overlap relief is, and also how a business will find out what its overlap profits are if it doesn't have a record of them.
- The option to spread additional profits over a maximum period of five years inevitably introduces complexity, which we are concerned will leave some unrepresented businesses at a disadvantage as they may be unable to do the

necessary calculations to enable them to make an informed decision about whether to spread the profits, especially when factoring in interactions with other entitlements that are based on taxable income.

We urged the government to ensure enough time is devoted to fully understanding the interactions between basis period reform and other areas of the tax system, as well as other areas of financial support such as tax credits, universal credit and student finance, so that unexpected and unintended consequences do not emerge at a later date. We recommended that steps are taken to mitigate any unintended consequences as a result of interactions and that, where any impacts remain, comprehensive guidance is made available to people and efforts made to raise awareness of these impacts.

The LITRG response can be found at www.litrg.org.uk/ref2545.

Basis period consultation: ATT response

While we believe that the proposed change presents an opportunity for simplification, we are also concerned about the timetable and pace of change, especially with many businesses still struggling with the impacts of the COVID pandemic, and the future outlook remaining uncertain.

We therefore strongly recommended that the implementation of these changes be pushed back to allow for more consultation and suggested that the basis period reform should not proceed until tax year 2023/24 at the earliest, with MTD for ITSA also delayed to at least April 2024 to allow time for that reform to bed in first.

We thought that, while not without its potential issues, the proposed tax year basis is the best option for simplifying the basis period rules, as it appears to deliver the best balance between simplicity and limiting adverse impacts for taxpayers.

We noted that the consultation also proposed two alternative options:

- mandating a 31 March or 5 April accounting date; and
- a corporation tax like approach with payment and return dates linked to the accounting period of the business.

We did not believe that either of these options are viable.

In our response, we also outlined specific issues which we think will affect averaging calculations for farmers and the creative industries, as well as concerns our members have raised regarding doctors' (specifically GPs') pensions.

The ATT response can be found at www.att.org.uk/ref382.