BASIS PERIOD REFORM

What is basis period reform and does it impact you?

From the 2024/25 tax year, all business profits from sole trades and partnerships which are subject to income tax, will be taxed on the profits arising in the tax year, no matter what their accounting year end is.

Currently businesses are taxed on the profits of an accounting period *ending* in a tax year, for example, accounts drawn up to 30 June 2022 are taxed in the 2022/23 tax year.

Many sole traders and partnerships already use the 31 March or 5 April as their accounting year end so these changes will not affect them.

However, many sole traders and partnerships have different accounting year ends, such as 30 June, 30 September or very commonly 31 December. The basis period reform will impact on these businesses and may result in higher tax payments in 2024/25, unless businesses take tax advice to understand what can be done to minimise the impact for them.

Business Owner – What should I be thinking about?

Businesses should consider whether to change their accounting year end.

There is no legal obligation for the business to change its accounting year to that of 31 March/5 April. HMRC expect many businesses to change their accounting date to 31 March (before 6th April 2023) to simplify the assessment of profits and avoid the need for provisional figures. However, there are commercial factors to consider when contemplating such a change.

Those businesses that do not change will have to make an apportionment to identify the profits arising in the tax year. This will mean that they must either have two years of accounts available at the time of preparing their tax return or will be required to use provisional figures for the period where accounts are not yet available. The taxpayer will then have to review and amend the provisional figures used on the tax return when their accounts are finalised. Effectively this means the taxpayer may have additional costs in the year, these are discussed further in this article.

Transitional Relief

The changes are likely to create larger tax bills and HMRC will be offering transitional relief to reduce this burden.

During the transitional tax year 2023/24, those businesses with a non-31 March/5 April accounting year will be taxed not only on the profits arising in their normal accounting period, but also on the profit for the number of months up to that tax year end. The transitional relief allows spreading of profits to help with the extra tax generated.

Depending on the accounting date of the business, this could bring almost up to two years' profits into charge for the year: businesses with 30 April year-ends could be particularly impacted. Given this could lead to a significantly increased tax bill, the proposals provide for the excess profit to be spread over a period of five tax years to mitigate the cashflow impacts.

It will also be possible to use accrued "overlap relief". If the business has any overlap profits, it must offset these against the profits of the 2023/24 tax year.

Businesses operating for many years may not know or have a record of their overlap profits, as this information may have been lost over time. These businesses will need to rely on HMRC to provide the figures.

Financial and Practical Implications

For businesses that do not currently have a 31 March/5 April accounting year end, the reforms may impact a business financially by:

- Accelerating tax payments.
- Pushing individuals into higher tax rate bands.
- Making businesses incur additional professional fees for the preparation of two sets of accounts or providing estimates which require prior year amendments on an ongoing basis.
- Result in a change to High Income Child Benefit Charge computation, student loan repayment calculations and in some cases, a loss of the tax-free personal allowance.

In addition to the financial implications, there are also a number of practical issues to be considered some of which are highlighted below:

- As the changes can be complex to understand, additional time and costs may be required to help businesses implement the necessary changes.
- Many business owners may need to consider whether their current trading vehicle i.e., a sole trade or partnership is the most appropriate for their business, going forward. If this structure is to be changed, the timing of this change can have many implications. This can be a complex process for many businesses.
- The implications on farmers averaging calculations.
- Pension planning implications.
- The changes may alter the optimal date for retirement.

How we can help

We recommend that our clients, who will be affected by these changes, speak with your client manager or the CavanaghKelly Tax Team and take advice now to help ensure they understand the real impact of these changes on their business, including:

- How to manage the immediate cash-flow impact of the changes;
- Consider changing their accounting date to 31 March to simplify the calculation of assessable profits from 2024/25 onwards;
- Consider whether incorporation would be beneficial for their sole trade/partnership business; and
- Businesses who commercially may not be in a position to change their accounting date, should consider the processes which need to be in place to file provisional and then final tax returns for each period.
- Engaging with HMRC as early as possible to confirm whether any overlap profit is available to reduce the profits.

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