Strabane Chronicle Business

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Basis period reform

LET'S TALK MONEY

SHAUN McGLADE

A basis period is taxation language given to the period of time used to establish taxable profits for which a sole trader or partnership pays tax each year.

The impending implementation of basis period reform signifies a significant shift in the taxation framework which may affect some businesses that are sole traders or partnerships across the North. In this article we will look at the ramifications of this reform for affected businesses and explore strategies for effectively navigating through these changes.

WHAT IS IT AND HOW MIGHT IT AFFECT YOU?

A basis period is accounting or taxation language given to the period of time used to establish taxable profits for which a sole trader or partnership pays tax each year. Usually the basis period will be the same as the accounting year using either the 31st of March or the 5th of April as accounting year end, however sometimes this may not be the case. Businesses with different accounting year ends (31st May, 31st December, etc) will be affected by varying degrees by basis period reform with the possibility of higher tax payments in 2024/25.

Basis period rules are required in the early years of a business's life, if the business owners are not preparing accounts to match the tax year, then they or their accountant will have to work out the profit for basis periods that don't match the accounting year and include those on the tax returns. This often results in having to pay tax twice on the same profits - but this tax is refunded if the business ceases to trade or changes its accounting year end.

Moving to the tax year basis period will require businesses to report for the 6 April – 5 April tax year for trading purposes, regardless of their actual period of account. For practical purposes, the proposed rules allow the periods to be apportioned by reference to months if it is reasonable to do so and this is applied consistently.

SOLE TRADERS & PARTNERSHIPS

In the short term, while the rules may simplify certain technical and practical matters, sole traders and partnerships that do not make their accounts up to 31 March/5 April will need to consider the impact of the proposed changes on their cash flow: particularly for the transitional year 2023/24 which could see partners paying tax on significantly increased amounts of profit.

Businesses should first consider whether changing their accounting year end is beneficial and practical. While there's no legal requirement to align with the 31st of March/5th of April, HMRC anticipates many businesses to transition to a March 31st accounting date (prior to April 6th, 2023) to simplify profit assessment and avoid provisional figures. However, commercial factors must be weighed before such a change.

Businesses that opt to maintain their current accounting date will need to apportion profits to identify those arising in the tax year. This could necessitate having two years of accounts available or using provisional figures until accounts are finalised, incurring additional costs and complexities.

TRANSITIONAL RELIEF

Anticipating larger tax bills due to the reform, HMRC offers transitional relief to ease the burden. In 2023/24, traders will normally have a basis period that runs from the day after the 2022/23 basis period ends until 5 April 2024. The first 12 months of the basis period is the 'standard part'. If the standard part ends before 31 March 2024, the remainder of the basis period is the 'transition part'. For example, if the trader draws up their accounts to 31 December every year, the standard part will normally be the year to 31 December 2023 and the transition part will run from 1 January to 5 April 2024.

'Transition profits' will be based on the profits of the transition part, on a time-apportionment basis, less any unused overlap profits. If there is excess overlap, it is set against the profits of the standard part. If transition profits are greater than zero, they are spread equally over the five tax years from 2023/24 to 2027/28 but the trader can make an election to accelerate all or part of them.

IMPLICATIONS

Although the tax year basis seems simple on the surface it is likely to create complexity in the future for traders who cannot align their accounting periods to the tax year. Whereas the current year basis gave finality at an early stage, the tax year basis will force affected traders to file provisional returns year after year. As well as the extra administrative burden of estimating profits and amending them later, it may have a knock-on effect on other issues such as pension tax charges and loss reliefs. It may also expose traders to interest charges if there is a discrepancy.

I have noted already the cash flow impact of higher tax payments from the potential shifting into higher tax bands which along with potentially additional professional fees for managing multiple sets of accounts and compliance but there are further considerations to be made including the potential to hit High Income Child Benefit Charges, student loan repayments and pension planning.

IT'S GOOD TO TALK

Reading the narrative provided by HMRC can be confusing for some as there are a number of moving pieces with this however we, as chartered accountants, can help to strip back the jargon to give clients an understanding of what is happening and to allow them then to best understand and manage the changes effectively, including mitigating cash flow impacts, considering accounting date changes, evaluating incorporation benefits, and establishing procedures for provisional and final tax returns.

● If you wish to discuss these or any other matters raised in this article, feel free to get in touch with a member of the team at SMCG Ltd on the contact details shown and we would be happy to help.