Basis Period Reforms

Summary of the reforms

- from 2024/2025, the profits of the tax year will be the profits arising in that tax year with accounting period profits being apportioned by the number of days or another reasonable basis
- there will be a transition year of 2023/2024 which will bridge the period between the end of the basis period for 2022/2023 and the start of the reformed basis period in 2024/2025
- in the transition year of 2023/2024, all overlap relief brought forward must be used and in subsequent years no further overlap relief can be created
- any additional profits arising for the business under the new rules will be spread over five tax years starting in 2023/2024, with an option to elect to accelerate the tax charge
- trading and property businesses can treat an accounting date between 31 March and 4 April inclusive as being equivalent to ending at the end of the tax year, and so would not have to make small apportionments of profits
- the changes apply to the self-employed, partnerships, trusts and estates with trading income. The changes will not affect companies apart from some non-resident companies

Frequently asked questions

Produced from Tolley

The following is a summary of frequently asked questions relating to the basis period reform which has a start date of the tax year 2024/2025, with a transitional period in 2023/2024.

Why are HMRC making these changes?

These changes are being made to simplify the taxation of trading profits, as after the transitional year the rules will be significantly simpler than they are at the moment. The current system allows two identical businesses, apart from their accounting date, to return different taxable profits and tax liabilities for the same tax year.

The new rules will remove this difference and remove the double taxation that some businesses experience in the early years of trading.

This is also being done to make it easier for businesses to report their income, particularly with 'making tax digital' being introduced for income tax in the future. The aim is to align trading income with other income sources such as property and investment income, which currently operate on a tax year basis.

Does a business have to change its accounting year end to match the tax year?

No, a business can maintain an accounting year which does not match the tax year, but for the purposes of completing its tax return the business will need to apportion profits or losses to tax years. This should be done by reference to the number of days in the periods, but other methods including using weeks or months can be

used if they are reasonable and used consistently. Where an accounting period ends later in the tax year, e.g. 31 December, the accounting period may not have ended when the apportionment is being done. In this instance, an estimation of the profits or losses will need to be made, with a revised return being submitted once final figures are known. HMRC is exploring other options to reduce the administrative burden in this instance.

Businesses that have a 31 March year end will be treated as having an accounting period that matches the tax year unless they elect out of this treatment.

For some businesses, changing their year end may not be an option given the circumstances of their trade, e.g. farming.

When is the best time to change accounting date?

The answer will depend on individual circumstances. One point to bear in mind is that spreading any additional profits can only take place if there is a transition period — this requires a non-31 March or 5 April period end to occur in the tax year 2023/24, so changing accounting periods earlier may lose the benefit and flexibility of spreading.

Moving from a 30 April year end to a 31 March or 5 April year end when there are low overlap profits because the business has grown over time could mean high amounts of profits falling in the transition period (i.e. an extra 11 months of profit less the overlap profit). In order to spread these higher profits, the accounting date change could therefore take place in 2023/24 to access the spreading provisions.

Alternatively, it may be better to have an extended period and higher profits sooner than 2023/24 if the business is planning high levels of capital expenditure which would benefit from the increased AIA to 31 March 2023.

An early change of accounting year end may also be beneficial where a business has suffered a downturn in business recently.

Generally, there is a restriction on the length of an accounting period for it to form a valid basis period to the new accounting date, i.e. the period must be no longer than 18 months. So, if an early change of accounting date is being considered, e.g. in 2022/23, where this results in a period that is longer than 18 months, two sets of accounts will need to be prepared when changing the date to 31 March.

Would it be better to split the move to a new accounting date?

Many businesses have 30 April or 30 June year ends to maximise the cash flow on tax liabilities, and moving to a 31 March accounting date under the basis period reform will mean the crystallisation of high levels of profits in the tax year 2023/24. This will be worse for businesses with little or no overlap relief due to losses in the early years of trading.

For example, a business with £30,000 taxable profits would be subject to a catch-up charge on the change of accounting date to 11/12 months x £30,000 = £27,500 spread over five years. At an effective tax and NIC rate of 30.25% this means an additional liability of £1,663.75 which is an increase of 30% above their expected liability prior to the reforms. Most businesses would have been aware that this extra profit would come into charge at some point, but the expectation may have been that this would happen on retirement when profits are lower and NIC may not be payable.

One option may be a half-way house change of accounting date, i.e. move the accounting date on six months in 2022/23 to utilise some basic rate band. This may be especially relevant if profits in that year were reduced by Coronavirus. Then the business could move to a 31 March accounting date in the transition year for basis period reform (2023/24). This would then still leave some profits to be covered by spreading relief as transition profits.

How are transition profits treated for Class 4 NIC?

Class 4 NIC will be chargeable on the additional profits taxed in the transition year.

Can a business bring in the spread profits earlier than over five years?

A business can be flexible about when the spread profits are brought into charge. The election allows the amount to be included in any tax year to be any amount, with the remaining balance being proportionately adjusted. Therefore, if the business has high capital expenditure in a tax year which qualifies for the AIA, it could elect to bring in additional profits for that year.

Why would you not spread the transitional profits over five years?

If you are thinking of changing your business circumstances, for instance you are looking to retire or sell your business in the next five years, you may want to consider not spreading the transitional profits.

If you already have the funds to pay the transitional period liabilities, you may feel this is more appropriate.

How do the transitional profits interact with other tax reliefs / allowances?

Transition profits will be separated out in the tax calculation as an extra component of income, and therefore will not affect the level of the taxpayer's net income used to calculate the pension annual allowance. The additional profits do not impact the high income child benefit tax charge.

What will be the impact on cash flow?

Businesses which do not make up accounts to the tax year or close to it will need to consider the impact of the transition year and the subsequent four years on their cash flow, with higher levels of profits being taxed in those years. In addition, the gap between the profits arising and being brought into charge will narrow.

Useful web links:

Income Tax: basis period reform - GOV.UK (www.gov.uk)

Basis period reform: explaining the changes | ICAEW

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