Finance Bill 2021-22 - Clauses 7-8 and Schedule 1 - Abolition of basis periods
Representation from the Low Incomes Tax Reform Group (LITRG)

1. Summary

- The existing rules on basis periods are complicated and difficult to understand and apply for low-income unrepresented[1] taxpayers. These complexities will be removed under these proposals, making it easier for such taxpayers to understand their tax position from the outset and comply with Making Tax Digital for Income Tax (MTD) requirements in future. However, for businesses who need to use an accounting date other than the tax year end (31 March/ 5 April) for commercial reasons, the proposals will increase complexity compared to the current system.

- In order to avoid transition profits creating unfair knock-on effects on certain allowances, benefits and non-tax areas such as student finance, the legislation has been made more complicated than originally proposed. Whilst it is welcome that HMRC has listened to our concerns, we seek assurance that they have assessed the number, and type, of people potentially affected by these numerous interactions in order to determine whether additional complexity for everyone affected by the reform is justified and proportional or whether other solutions would be more appropriate.

- Due to the complexity of the transitional rules being introduced, as well as the decisions that will need to be made about whether to change accounting date and whether to spread the transitional profits up to five years, HMRC must be adequately resourced to provide guidance and support to taxpayers.

- Although we welcome the recently announced delay in both basis period reform and MTD, April 2024 is still a very tight timescale in which to have implemented basis period reform and bring in MTD. Ideally, we would rather see basis period reform introduced and settled first, which would necessitate a further delay in the MTD timetable, say to start from April 2025.

[1] Unrepresented taxpayers refers to those who do not use an agent or adviser to help them deal with their tax affairs. LITRG's focus is on those least able to afford to pay for tax advice.

2. General comments

2.1. These changes mean the ongoing complexity of existing 'basis periods' is removed and tax for the self-employed (including partners) will be based on profits in the tax year. This will be easier for unrepresented taxpayers (who are often on a low income) to understand and will stop double taxation by removing the formation of 'overlap profits'.

2.2. We hope that the new rules will encourage new businesses to choose either 31 March or 5 April as their accounting date where possible. We believe this will help those who are newly self-employed to better understand their tax affairs from the outset[1]. However, these changes may increase ongoing complexity, compared to the current system, for those who need an alternative accounting date for commercial reasons[2]. According to the equalities impact document[3], these businesses will include farmers, other seasonal businesses and larger partnerships. We would expect most of these to be represented.

2.3. Whilst we do agree that the proposals will make the basis on which tax is paid easier to understand for low-income unrepresented taxpayers, there are potentially other ways that this same simplicity could be obtained for this group – for example by the introduction of a default year end[4]. This would avoid the creation of additional complexity (compared to the existing system) for those who cannot change their accounting periods for commercial reasons. However doing this would not achieve the same alignment with MTD or remove the tax deferral advantages of choosing a particular accounting date – both of which were stated as rationales for the current proposals.

2.4. The Making Tax Digital for Income Tax (MTD) Regulations were laid after the consultation for Basis Period Reform closed[5] and it is now clear that having an accounting period ending on 31 March or 5 April will make compliance with MTD much more straightforward. Therefore, if as a result of this change more businesses use an accounting period that aligns with the tax year, compliance with MTD should be more straightforward for them.

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[1] In our paper 'A better deal for the low income taxpayer' https://www.litrg.org.uk/latest-news/reports/201204-better-deal-low-income-taxpayer we proposed a default year end of 31 March (or 5 April) for new businesses as a simplification measure. We envisaged an option to elect for an alternative year end to still be available to accommodate, for example, some seasonal and international businesses who may prefer a different year end for commercial reasons.

[2] There are many commercial reasons why a business may use an alternative accounting date – for example farmers who align their accounting periods to the production cycle. Analysis by the National Farmers Union, for example, shows cereal farms in England may choose a 30 September accounting date and in Scotland a 30 November date to determine how the business has performed over an annual production cycle. https://committees.parliament.uk/writtenevidence/39967/pdf/

[3] https://www.gov.uk/government/publications/basis-period-reform/basis-period-reform#policy-objective

[4] As suggested in our paper 'A better deal for the low income taxpayer' https://www.litrg.org.uk/latest-news/reports/201204-better-deal-low-income-taxpayer for new businesses. Existing businesses could be supported by HMRC to change their accounting date under the existing rules.

[5] https://www.legislation.gov.uk/uksi/2021/1076/contents/made

3. Complexity of Schedule 1

3.1. The draft legislation is complex and will in parts (in particular paragraphs 70 and 75) require additional guidance and detailed examples from HMRC. However, we understand that one of the reasons for this complexity is to maintain fairness to taxpayers when considering any interactions with benefits, tax-related allowances, student finance and the High Income Child Benefit Charge (HICBC). This is because the transition profits would, for those periods, increase the person's income for those other purposes – for example this might mean the HICBC would become due, tax credits may reduce, their child might lose student finance support. However, the individual would not actually see an increase in their income.

3.2. Unfortunately, in our experience it is not always the case that all impacts, including non-tax impacts, are considered when making tax policy. An example of where there have been unintended consequences adversely affecting basic rate taxpayers is the change to tax relief on interest costs to residential landlords[1]. We understand that paragraphs 70 and 75 have been drafted to avoid potential unfairness in respect of these other interactions. It is welcome that HMRC have listened to our concerns[2] about this issue on this occasion. However, it is not clear to what extent HMRC have carried out any assessment of the number/type of taxpayers affected by the potential interactions. This assessment is necessary to then determine whether the additional complexity introduced for everyone affected by the reform is justified and proportionate or whether other solutions might be more appropriate.

3.3. The option to spread additional profits over a maximum period of five years gives welcome flexibility to taxpayers, but also inevitably introduces complexity. Good clear guidance must be provided to enable unrepresented taxpayers to be confident to make informed decisions about whether to elect not to spread the profits. An election can be done each year during the five-year spreading period which gives maximum flexibility.

4. Guidance and support from HMRC

4.1. HMRC estimates that 75,000 unrepresented sole traders do not have a 31 March or 5 April accounting year end. These people will be affected by the proposed changes and will have to decide whether or not to change their accounting period end date in 2023/24. In order to make such a significant decision it is imperative that they have the right level of support at the right time from HMRC.

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[1] See page 47-48 of our paper 'A better deal for the low income taxpayer' https://www.litrg.org.uk/sites/default/files/files/LITRG-A-better-deal-for-the-low-income-taxpayer-2020.pdf

[2] See section 6 of our response to the consultation on Basis Period Reform: https://www.litrg.org.uk/sites/default/files/files/210825-LITRG-response-Basis-reform-period-consultation.pdf

4.2. In the transition year, these taxpayers will also need to use any 'overlap relief' they may have accrued. This arises as a result of 'overlap profits' (historic profits which have been taxed in more than one tax year) in earlier tax years. Many unrepresented taxpayers will be relying on HMRC for:

- information about their overlap profits and available overlap relief; and

- detailed clear guidance explaining what they need to do if they decide to change their accounting period.

4.3. We anticipate that many unrepresented self-employed taxpayers will change their accounting date to 31 March (or 5 April) once they realise how complicated and time-consuming estimating profits on an ongoing basis will be - unless there are commercial reasons for them not to do so.

4.4. It is not known how many of the 75,000 sole traders affected will have a commercial reason for keeping a different year end. It is also unclear how many of the total 278,000[1] represented and unrepresented sole traders and partners, who HMRC expect to be affected by the additional complexity due to having to estimate profit figures, have a commercial reason for keeping a different year end. We would expect a smaller number in the unrepresented population than in the represented population. Therefore, we would urge HMRC to make it as easy as possible to change accounting dates to 31 March or 5 April and also to ensure there is good detailed practical guidance available to enable taxpayers to do this easily themselves.

4.5. The timing of this message will be crucial as affected taxpayers will need to make the decision in sufficient time before the end of the transitional tax year (2023/24). However key messages about completing tax returns, such as guidance notes, are usually published after the end of the tax year – which for this purpose will be too late!

4.6. Through targeted communications HMRC should also proactively identify and contact unincorporated businesses with accounting period ends other than 31 March or 5 April. These messages should encourage businesses to consider the impact of basis period change as soon as possible and also let them know what overlap profit information (if any) is held on HMRC's records. We understand that HMRC has budgeted for resources to help with this, which is a positive step. We would also like to see HMRC's extra support service better publicised so that vulnerable taxpayers can get the specialist support they may well need.

4.7. For those businesses who choose not to change their accounting period end to 31 March/ 5 April, HMRC are considering various approaches to minimise the burden caused by having to submit tax returns containing provisional figures. We welcome the opportunity to be involved in relevant discussions as we consider it important to provide an approach which will be understandable for those unrepresented businesses which will be affected from the 2024/25 tax year onwards.

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[1] https://www.gov.uk/government/publications/basis-period-reform/basis-period-reform. The consultation (https://www.gov.uk/government/consultations/basis-period-reform/basis-period-reform-consultation) states that '93 per cent of sole traders and 67 per cent of business partnerships that draw up their annual accounts for a period that is aligned with the tax year ending on 5 April or 31 March', therefore 7% of sole traders and 33% of partnerships will be affected by basis period reform.

5. About Us

5.1. The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998, LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low-income workers, pensioners, migrants, students, disabled people and carers.

5.2. LITRG works extensively with HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.

The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

LITRG
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