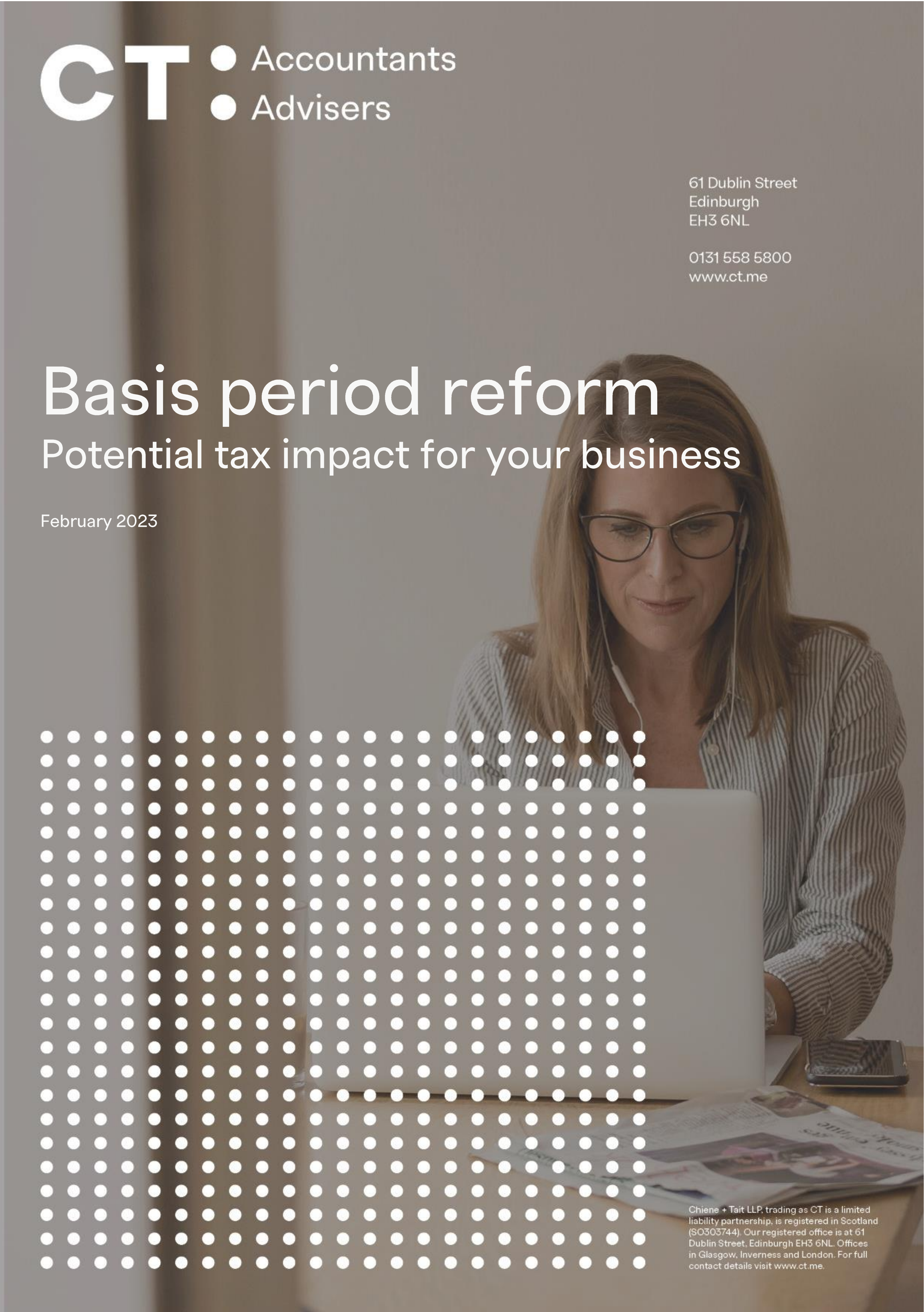

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Basis period reform

Potential tax impact for your business

February 2023

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Basis period reform: Potential tax impact for your business

Changes to the taxation of unincorporated business profits are coming which may be lead to a higher tax bill for the 2023/24 tax year.

Under current rules, business profits for tax purposes are assessed according to defined “basis periods”. Broadly, a business’ basis period will match its accounting period, with the profits from the accounting period ending in the tax year being those assessed to income tax. The rules for establishing the basis period in the early and final years of a business can be complex.

What is changing?

The concept of basis periods was abolished in Finance Act 2022 and replaced by the “tax year basis” from 2024/25. Transitional rules will apply for 2023/24.

The new rules will ensure that profits and losses going forward will apportioned to tax years where a business’ accounting period does not end on either 31 March or 5 April. From 2024/25 all businesses will be taxed on profits arising in the tax year. Apportionments will generally be made on a straight pro-rata basis, but reasonable alternative methods will be allowed.

For established businesses, the basis period for 2023/24 will start immediately after the end of the basis period for 2022/23 (“standard part”) and end on 5 April 2024 (“transition part”).

What are the impacts?

If a trader has transition profits for the tax year 2023/24, the rules by default spread these over five tax years (20% per year). However, the trader can elect to spread over a shorter period if preferred. See the following page for a straightforward example of the change. In broad terms, traders with profitable businesses can expect an element of their profits to be taxed sooner than would be the case under current rules.

Where the transitional profit takes a taxpayer over £100,000 of adjusted net income for the relevant tax year, that taxpayer’s personal allowance will be restricted. However, transitional profits are not taken into account when assessing whether the £50,000 threshold for the High-Income Child Benefit Charge has been breached. Also, the transition profit does not impact the thresholds for the pension contributions annual allowance tapering.

What should you be considering?

Regardless of how the transitional profits are spread, there is likely to be a negative cash flow impact for affected traders. It is extremely important that, before undertaking any exercise to carry out an impact assessment, you have good forecasts for what your cash flows and likely profits will be for the coming years. This will serve as a basis for determining the most beneficial actions you can take for your own business to manage the changes. Some aspects to be considered include:

Aligning accounting period with year-end – This will be particularly helpful to those with later accounting year ends as there may exist the practical problem of relevant accounts not being finalised in time for the tax reporting deadline on the 31 January. Where the accounts are not ready, this would require estimates to be made of the tax position which will then require adjustment later.

Capital allowances – If you have plans to incur qualifying capital expenditure then particular care should be taken as to the timing of this to maximise relief. This will also feed into whether you should use a long or short accounting period to align with the tax year end.

Overlap profits – Do you know how much you have at your disposal and what impact they will have?

Pension contributions – Are increased contributions worthwhile to decrease your tax bill?

Incorporation – Companies are not affected by the changes so this may be an option?

An exit – Perhaps the changes, along with the impending introduction of Making Tax Digital for Income Tax Self-Assessment, will turn thoughts towards retirement or passing on your business?

Example
A sole trader prepares accounts to 30 September each year. Trade profits for the year ended 30 June 2023 are £30,000, and £25,000 for the year ended 30 June 2024. There are overlap profits of £5,000 from when the trade commenced.

Taxable profits for the 2023–24 tax year will be calculated as follows:

Step 1:	Profit for the standard part of the basis period 1 October 2022 to 30 September 2023:	£30,000
Step 2:	Profit for the transition part of the basis period: 1 October 2023 to 5 April 2024: £25,000 x 188/3661	£12,841

Step 3:	Deduct overlap profits from Step 2 amount: £12,841 - £5,000	£7,841
Step 4:	Add the Step 1 and Step 3 amounts: Step 4 amount is not nil or less, proceed to Step 5	£37,841
Step 5:	Determine transition profits for 2023–24: Lower of Step 3 and Step 4	£7,841
Step 6:	Step 1 amount is not nil or less, profits for 2023–24: Step 1 amount plus the transition profits treated as arising in the tax year*	£31,568

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* Note that 2024 is a leap year.

Special rules apply to taxing the transitional profits for 2023–24, assuming no elections have been made to charge a larger amount, 20% of the Step 5 amount is treated as arising in the tax year.

Need more help?

Please contact Louise Anderson at louise.anderson@ct.me

- Information correct at February 2023.

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