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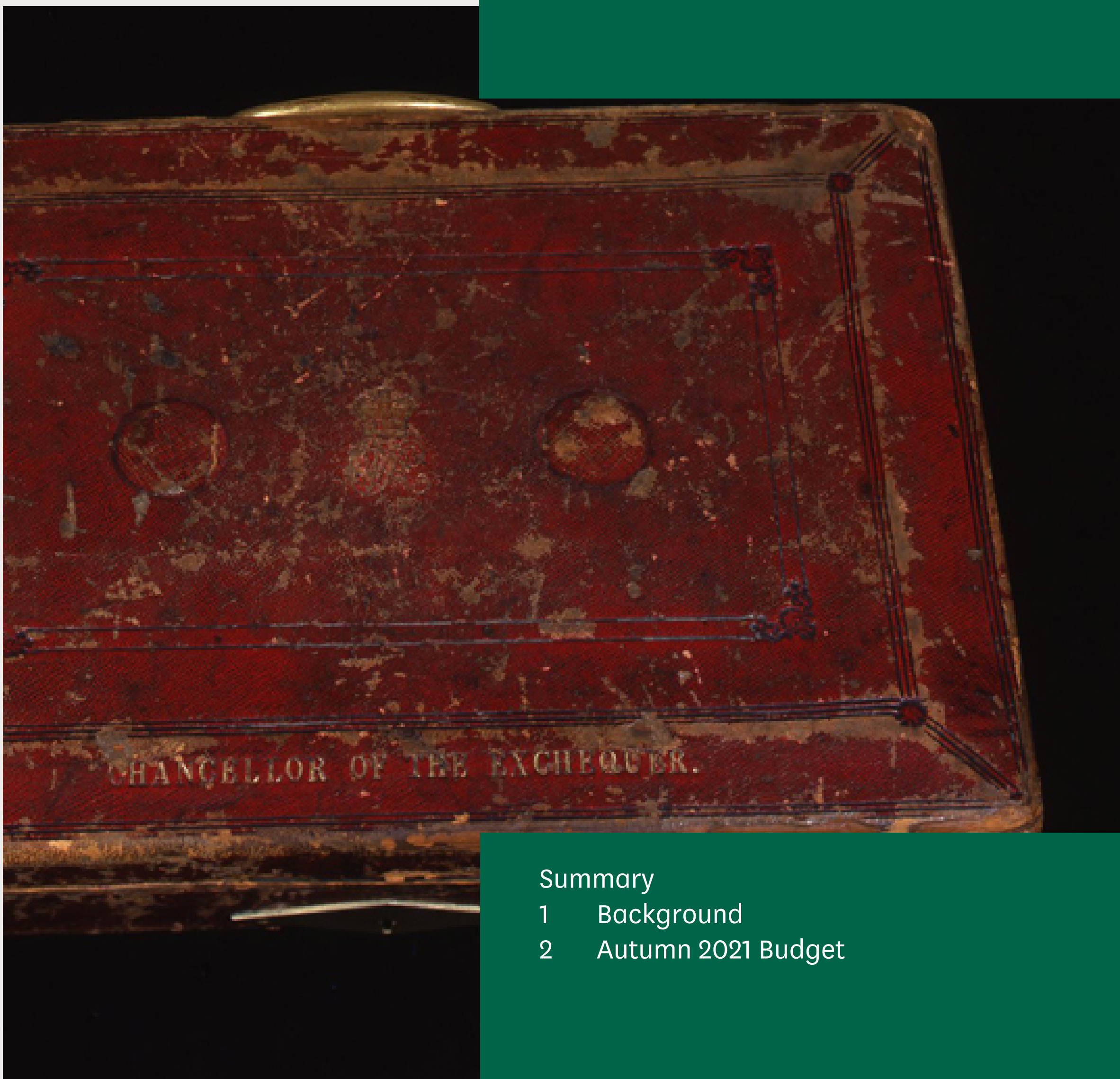
Autumn 2021 Budget: Basis period reform



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Summary

Currently, a business's profit or loss for a tax year is usually the profit or loss for the year up to the accounting date in the tax year, called the 'basis period'. Specific rules determine the basis period in certain cases, including during the early years of trading. These rules can create overlapping basis periods, which charge tax on profits twice and generate corresponding 'overlap relief' which is usually given on cessation of the business. Overall, this basis of taxation is called the 'current year basis'.

Following a consultation exercise in summer 2021, the Government announced in the Autumn Budget and Spending Review 2021 that it would reform these rules with effect from 6 April 2024.

In brief, this measure changes the 'currrent year basis' to a 'tax year basis' with effect from the tax year 2024 to 2025, so that a business's profit or loss for a tax year is the profit or loss arising in the tax year itself, regardless of its accounting date. This removes the basis period rules and prevents the creation of further overlap relief. On transition to the tax year basis in the tax year 2023 to 2024, all businesses' basis periods will be aligned to the tax year and all outstanding overlap relief given.

Provision to this effect is included in the Finance (No.2) Bill 2021-22 - specifically clauses 7-8 of the Bill.

1 Background

1.1 Spring Budget 2021: Call for Evidence on Tax Administration

At the time of the Spring 2021 Budget the Government published a number of tax consultations, [1] and, as part of this, a call for evidence seeking views on how the legislation underpinning HM Revenue & Customs' (HMRC) administration of the tax system could be updated. Stakeholders were asked for their views on a number of issues, including how the process for calculating and assessing tax liabilities could be improved. HMRC's paper provided a summary of the current approach:

> The rules, processes, time limits and obligations for calculating liability vary according to different taxes and duties, and taxpayer circumstances.
>
> A common form of assessment is Self Assessment. This is made through an annual return by individuals and companies who meet the relevant criteria. The standard Self Assessment process often involves multiple stages that take time to complete and can lead to mistakes. Before filing a tax return, an individual must notify HMRC of their liability to pay tax. HMRC then sends them a notice to file, obliging them to file a tax return.
>
> The time limits to send that return to HMRC will depend on the method of filing used, online or paper, and when the notice to file is given. If a taxpayer fails to file a return in response to a notice to file, HMRC may determine to the best of their knowledge the amount of tax due, and unless the taxpayer files their tax return, this 'determination' is treated as if it were a Self Assessment. Once a tax return is filed, a taxpayer may amend their return at any time within 12 months of the date their return was due to be filed. HMRC may also amend taxpayer returns, to correct any obvious errors or omissions, within 9 months of the return or amendment being made.
>
> Different tax regimes have different procedures and time limits. For VAT, for example, people liable to pay must generally complete and file quarterly tax returns, accounting for and declaring the VAT due. If HMRC believes a taxable person owes further VAT, it may issue assessments for the relevant amount.

1 Written Statement WS873, 23 March 2021.

> Across taxes and duties, current assessment procedures drive a number of required interactions between taxpayers and HMRC which are sometimes complex to navigate. This can create friction and uncertainty, undermining trust and compliance in the process and increasing administrative burdens for both taxpayers and HMRC.[2]

Digitisation provided opportunities for reform – specifically the ability to estimate tax liabilities and process tax reliefs in real time:

> Digital advancements and modernisation (by both HMRC and the wider market), including through HMRC's Making Tax Digital (MTD) programme, should create opportunities to simplify and improve the taxpayer experience.
>
> The fundamental benefits of a modern digital business model are well understood with millions of businesses routinely securing orders, banking, paying invoices, and discharging their legal and regulatory obligations online. Ensuring they can seamlessly interact with HMRC is a logical progression, which will enable them to spend less time on tax and more on their core business activities. …
>
> The greater use of digitisation will provide further opportunities for estimating liabilities and processing tax reliefs in real time. The tax framework should complement and enable these changes to make the most of these advancements and ensure the benefits from tax modernisation are felt by both taxpayers and agents, as well as HMRC.[3]

One opportuntiy for simplification would be changing the way businesses allocated their profits to a tax year when filing their tax return ('basis periods'):

> **Box 4.1: Basis Periods – Example of a simplification opportunity**
>
> - Basis periods, the way in which profits are allocated to a tax year for the purposes of calculating the trading income, could be an opportunity for simplification of the current tax filing and calculation process for Income Tax.
> - Self-employed taxpayers currently allocate trading income to tax years using basis period rules. Normally, trading income for a tax year is based on the profits for a period of accounts ending in that tax year. This leads to complexities for businesses that do not draw up their accounts to 5 April or 31 March each year. Some profits are taxed twice, which adds an additional layer of complexity by introducing the need for overlap relief.

2 HMRC, The tax administration framework: Supporting a 21st century tax system - Call for evidence, 23 March 2021 p18. The closing date for comments was 13 July 2021.

3 HMRC, The tax adop.cit. ministration framework: Supporting a 21st century tax system - Call for evidence, 23 March 2021 pp18-9. The closing date for comments was 13 July 2021.

- A possible opportunity to simplify this would be to tax trading income for a tax year based on the income arising in that tax year. This would align trading income with other types of income, and could help facilitate future modernisations of Income Tax.[4]

1.2 Consultation on Basis Period Reform

On 11 July 2021 the Government published draft legislation for the forthcoming Finance Bill, which would be introduced after the Autumn 2021 Budget.[5] This procedure – commonly known as 'L-Day' – is part of the Government's tax policy-making framework, to allow for technical consultation on the drafting of tax law and to provide taxpayers with predictability over future changes.[6] This draft legislation included draft clauses to reform the rules for basis periods.[7] In addition HMRC launched a consultation exercise, asking for views on "the detailed design of the proposal, exploring which businesses are most likely to be affected, what benefits the proposal is likely to bring and how best to minimise the downsides."[8]

The paper noted that although these rules were straight forward for most businesses, having an accounting date different to the end of the tax year posed a serious risk for small businesses making errors in their tax returns:

> The current rules date back to the mid-1990s and are themselves derived from a system that dates back to the 1920s.
>
> The rules are straightforward for the 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, which HMRC normally treats as equivalent to 5 April).
>
> But choosing an accounting date different to the tax year-end creates complexities that lead to businesses making many thousands of tax return errors every year. While large firms and those with professional advisers understand the rules and find them straightforward to apply, less sophisticated taxpayers find the rules opaque, illogical and unfair. Tellingly, more than half of businesses affected by this complexity do not claim the relief they are entitled to.[9]

The text box over the next 2 pages reproduces a detailed explanation.

4 op.cit. p19
5 Written Statement WCWS204, 20 July 2021
6 HM Treasury, The new Budget timetable and the tax policy making process, 6 December 2017
7 For details see, HMRC, Income Tax: basis period reform, 20 July 2021.
8 HMRC, Basis period reform consultation, updated 4 November 2021. The consultation ran from 20 July to 31 August 2021.
9 HMRC, Basis period reform – consultation, updated 4 November 2021 (Foreword)

How does the Current Year Basis work?

Basis periods are the method by which taxable profits or allowable losses are allocated from a business's accounts to a specific tax year. Basis periods apply to the trading income of unincorporated businesses, such as the self-employed, partners in trading partnerships, and trading trusts and estates. In some cases, the rules apply to other untaxed income of partnerships, and to the trading income of non-resident companies.

The basis period system uses the 'current year basis'. This system was introduced alongside Income Tax Self-Assessment in the 1990s, and uses the general rule that the basis period for a tax year is the period of 12 months ending with the accounting date in that tax year (section 198 of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA05)). There are additional rules for determining a business's basis period depending on how many years the business has been trading (sections 199-202 ITTOIA05), and if it changes its accounting date during the year (sections 214-220 ITTOIA05).

A business's accounting date is normally the date to which it draws up its accounts, acting as a direct link between a business's accounts and the profits or losses it makes during a tax year (section 197 ITTOIA05). However, tax law does not require a business to produce accounts, or to produce them to a specific date. Therefore, specific rules exist for defining an accounting date if a business does not draw up accounts during the tax year, or if a business uses one of a range of dates to draw up their accounts each year (sections 201 ITTOIA05, 211-213 ITTOIA05).

In the first 3 tax years of trading, special rules apply to prevent small amounts of overlap profit from arising. These rules effectively treat accounting dates between 31 March and 5 April as equivalent, as long as the profit falling in the excluded days is included in the next basis period (sections 208-210 ITTOIA05).

Taken together, these basis period rules mean that there is always a single basis period for each tax year in which a business operates, and these basis periods generally tax at least 12 months' worth of profits each tax year.

The rules of the current year basis mean that in certain circumstances basis periods can overlap. The profit arising in the overlap period is then taxed twice, once in the first basis period's tax year and again in the second basis period's tax year. To balance this double taxation, corresponding overlap profits are carried forwards by the business. A deduction for these overlap profits is then given when the business changes its accounting date or ceases to trade, to ensure that the profits over the life of the business are only taxed once (sections 204-207 ITTOIA05 and section 220 ITTOIA05).

The basis period rules can create a significant time lag between the end of the basis period for a tax year and the end of the tax year itself. Any accounting date falling before 5 April creates a lag between the basis period and the tax year, shifting the period over which profits are assessed backwards relative to the tax year. In the extreme case, an individual whose accounting date falls on 6 April will experience a basis period that covers almost none of the tax year that the profits are being allocated to.

How does the Current Year Basis work? (2/2)

The current year basis is effective in providing certainty and consistency for individuals with trading income. The rules guarantee a basis period for each tax year that the business trades in, and that this basis period will nearly always be at least 12 months long. The connection between a business's basis period and its period of account under the general rule makes taking figures from accounts and moving them into tax returns more straightforward, as it does not require apportionment.

However, in ensuring that the current year basis captures all the profits of the business and provides a level of certainty over basis periods, the system has created a complex set of rules and a relief that exists purely for tax purposes. This complexity brings significant downsides for businesses, who find it difficult to understand and apply the basis period rules. The rules on overlap relief are an area of particular complexity, with most eligible businesses not claiming the relief when they should. These businesses may not know they are eligible to use relief, do not know how to calculate relief, or may have lost track of their relief over time.

This complexity leads to error, failure to engage with basis periods, or use of the relatively simpler 5 April accounting date when another date may make more commercial sense. Evidence shows that many self-employed individuals are making mistakes with basis periods each year. For example, when asked to inform HMRC of their basis period for the tax year on the full tax return, 22% of sole traders do not fill in the boxes in their return. Also, a significant number of traders report overlap relief brought forward despite having a 5 April accounting date, which should be impossible.

The burden of the basis period rules falls particularly on new businesses in the early years of trading, who have to deal with a specific set of rules for the first three years of trade. Many businesses do not trade for more than 3 years, meaning they may never escape the complex early years of trade rules. The burden also falls on businesses who experience overlap taxation, having their profits taxed twice and waiting many years until they are able to access the corresponding relief. Overlap taxation acts as a direct tax cost in the early years of trade, diverting funds away from business investment and growth.

Source : HMRC, Basis period reform – consultation, 4 November 2021 para 2.1-2.11

The paper proposed moving from a current year basis to a tax year basis …

> The 'tax year basis' would replace the 'current year basis' entirely, with the tax year basis applying to the trading income of the self-employed, trading partnerships, and in any other cases where the current year basis is used. It would mirror the basis of assessment used in other forms of income, such as property income and miscellaneous income, using similar or identical rules and definitions.
>
> The 'tax year basis' would set the tax year as the basis of assessment, covering profits and losses arising from 6 April to 5 April each tax year. The tax year basis would not mandate a specific accounting date or period of account for businesses. This means that a business's choice of

> accounting date would no longer have any impact on its taxation. Businesses would be free to choose any period of account without having to consider the basis period implications, and so would gain greater flexibility in drawing up their accounts for the period that suited them commercially.

… and gave a short example of how it would work in practice:

> A business draws up accounts to 30 June every year.
>
> Currently, income tax for 2023 to 2024 would be based on the profits in the business's accounts for the year ended 30 June 2023. Part of the accounts are outside of the tax year, and part of the tax year is not included in profits taxed.
>
> Our proposed reform would mean the income tax for 2023 to 2024 would be based on:
>
> - 3/12 of the income for the year ended 30 June 2023, plus
> - 9/12 of the income for the year ended 30 June 2024.[10]

The consultation paper proposed a transition to the tax year basis in 2022/23, noting that this would simplify the introduction and experience of Making Tax Digital for Income Tax. The following section of this briefing provides some background.

1.3 Making Tax Digital

To give a little background, in December 2015 HMRC published Making Tax Digital - its strategy to implement a new system of digital tax accounts to be used by businesses, the self-employed and landlords. Initially it was proposed that the new system would be rolled out over two years, first applying to income tax returns (in 2018), and then extended to VAT (in 2019) and corporation tax (in 2020).[11] The timetable has been subject to a series of revisions over the last few years,[12] so that this system was first introduced for VAT from April 2019.[13]

In July 2020 the Government published draft legislation for the next Finance Bill, and as part of his statement on L-Day the then Financial Secretary, Jesse Norman, gave a statement setting out a revised roadmap for the programme; an extract is reproduced below:

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10 op.cit. para 3.3-3.4, Executive Summary

11 HMRC, Making Tax Digital, December 2015 (see, Timeline, at pp11-12)

12 Spring Budget 2017, HC 1025, March 2017 para 3.39; HM Treasury press notice, Next steps on the Finance Bill and Making Tax Digital, 13 July 2017; Written Statement HCWS1407, 13 March 2019

13 For more background see, Making Tax Digital, Commons Library briefing CBP7949, 12 July 2019

- The Government is therefore announcing a roadmap for HMRC's **Making Tax Digital** programme. Since April 2019, most VAT-registered taxpayers with a turnover above the VAT threshold have needed to operate Making Tax Digital for their VAT returns, keeping their records digitally and updating HMRC through secure software. Over 1.4 million taxpayers are successfully using this system. This includes over 30% of VAT-registered businesses with turnover below the VAT threshold who have joined voluntarily. The Government will introduce legislation in Finance Bill 2020/21 to extend Making Tax Digital for VAT to all businesses below the VAT threshold from April 2022, to ensure every VAT-registered business takes the step to move to a modern, digital tax service.

- The Government remains committed to extending Making Tax Digital to other taxes. The Making Tax Digital programme will therefore be extended through new regulations to businesses and landlords within Income Tax Self-Assessment from April 2023. This timetable allows businesses, landlords and agents time to plan, and gives software providers enough notice to bring new Making Tax Digital products to market, including free software for businesses with the simplest tax affairs. HMRC will expand its pilot service from April 2021 to allow businesses and landlords to test the full end-to-end service before the requirement to join.

- The Government will also consult in the Autumn on the detail of extending Making Tax Digital to incorporated businesses with Corporate Tax obligations.[14]

Subsequently on 23 September 2021 the Financial Secretary Lucy Frazer announced that, in recognition of the challenges businesses had faced over the pandemic and stakeholder feedback, the rollout of MTD for income tax would be deferred another year. In addition the reform to the basis period rules would not be implemented before April 2024, with a transition year not coming into effect earlier than 2023.[15] Alongside this statement HMRC published an impact assessment of the introduction of MTD for income tax,[16] and, a paper to help different businesses understand what their transition to MTD could look like in more detail.[17]

The Minister's written statement is reproduced in full in the text box overleaf.

14 Written Statement HCWS400, 21 July 2020. The Government also published a strategy paper on tax administration: HMT/HMRC, Building a trusted, modern tax administration system, 21 July 2020.

15 Written Statement HCWS308, 23 September 2021. See also, Autumn Budget and Spending Review 2021, HC822, October 2021 para 5.72; "MTD: the final countdown", Tax Journal, 5 November 2021.

16 Extension of Making Tax Digital for Income Tax Self-Assessment to Businesses and Landlords, 23 September 202

17 Customer costs and benefits for the next phases of Making Tax Digital, 23 September 2021

Update on Making Tax Digital : Written Statement HCWS308, 23 September 202

The Government has set out an ambition to become one of the most digitally advanced tax authorities in the world.

Making Tax Digital (MTD) is the first phase of our move towards a modern, digital tax service fit for the 21st century. It supports businesses through their digitalisation journey and provides a digital service that many have come to expect in their everyday lives. MTD helps businesses reduce common errors in their tax affairs and allows for better customer interaction and guidance through digital prompts and nudges.

Since the introduction of MTD for VAT in 2019, over 1.5m businesses have joined and many are already experiencing benefits. MTD users are reporting that preparing and submitting returns is easier, and that MTD has increased their confidence in managing tax affairs and using technology. MTD also puts businesses on a path to further digitalisation: integrating tax management with a range of business processes can contribute to productivity gains.

During the pandemic, UK businesses increasingly turned to digital tools to communicate remotely and work collaboratively. Businesses adapted rapidly to the challenges posed by the pandemic, using digital solutions to maintain resilience and reduce disruption.

Over the past year, HMRC have worked closely with partners in the business and tax communities on the proposed design and scope of MTD for Income Tax (ITSA).

Today the Government has laid Regulations in Parliament to help those impacted by the changes to prepare, and for their representatives to develop their own support and guidance.

The Government recognises the challenges faced by many UK businesses and their representatives as the country emerges from the pandemic over the last year. In recognition of this and of stakeholder feedback, we will now be introducing MTD for ITSA a year later, in the tax year beginning in April 2024.

General partnerships will not be required to join MTD for ITSA until the tax year beginning in April 2025. The date at which all other types of partnerships will be required to join will be confirmed later.

In March 2021, the Government announced a new system of penalties for the late filing and late payment of tax for ITSA. This will now be introduced for those who are mandated for MTD for ITSA in the tax year beginning in April 2024, and for all other ITSA customers in the tax year beginning in April 2025.

Alongside the Regulations, HMRC have also today published a Tax Information and Impact Note (TIIN) setting out the projected benefit and cost impacts of MTD for ITSA, as well as a Policy Paper to help different businesses understand what their transition to MTD could look like in more detail.

A later start for MTD for ITSA provides more time for those required to join to make the necessary preparations and for HMRC to deliver the most robust service possible, affording additional time for testing in the pilot.

HMRC will continue to work in close partnership with business and accountancy representative bodies and software developers to ensure taxpayers are well supported as they adopt MTD for ITSA.

The Government has also recently consulted on a reform of the complex basis period rules that govern how self-employed profits are allocated to tax years. Many respondents said that the reform was a sensible simplification but asked for more time to implement the changes. In recognition of these concerns, these changes will not come into effect before April 2024, with a transition year not coming into effect earlier than 2023. The Government will respond to the consultation in due course providing the next steps.

1.4 Outcome of consultation on basis periods

HMRC published a summary of the responses it had received following the Autumn 2021 Budget. Although most respondents agreed the reform was a simplification, many thought the proposed reform would make tax administration more complicated and expensive for them, and that the reform was being introduced too quickly. A number of specific concerns were raised, including:

- Agents not having sufficient time to plan for the change and communicate the effect of the change to clients. Many respondents asked for a one-year delay to the implementation of the reforms.
- The impact the reforms would have on certain sectors. Specifically, it was suggested that farmers, medical professionals and businesses with international connections would find it difficult to align their accounting date with the tax year, so would be forced to apportion their profits and in some cases, submit provisional figures.
- The burden of submitting provisional figures in returns and then amending them at a later date was flagged as a concern by a number of respondents. In particular, larger partnerships voiced their concerns in relation to the interaction between provisional figures and the process of deciding partner profit shares.
- Apportionment of profits into tax years was also flagged as an additional burden, although not a significant one.[18]

The paper noted the decision to postpone the introduction of this reform and MTD for Income Tax for a year, and went on to set out a number of changes of detail to the proposed rules in response to the consultation:

> First, the government has decided to treat any excess profits arising during the transition year as a one-off separate item of taxable income, rather than as part of a business's normal trading income. This treatment will minimise the impacts on allowances and means-tested benefits that were raised during the consultation.
>
> The government has also decided to extend the carry-back of loss relief arising due to excess overlap relief in the transition year from one to three years. This treatment will mirror the current rules for loss relief when a business ceases and provides the greater flexibility around use of excess overlap relief requested by some respondents during the consultation.
>
> Finally, the government will explore carefully with stakeholders whether to introduce administrative or policy easements to minimise burdens caused

[18] HMRC, Basis Period Reform consultation outcome: Summary of responses, 4 November 2021 (Introduction)

by having to submit tax returns containing provisional figures, ahead of the transition year in 2023 to 2024. The options being considered are:

- allowing taxpayers to amend a provisional figure at the same time as they file their return for the following tax year
- allowing an extension of the filing deadline for some groups of taxpayers, such as more complex partnerships or seasonal trades
- allowing taxpayers to include in the next year's tax return any differences between provisional and actual figures in the previous year
- leaving the current rules on provisional figures unchanged, whereby profits can be estimated in a return and amended as soon as final figures become available.[19]

[19] HMRC, Basis Period Reform consultation outcome: Summary of responses, 4 November 2021 (Next Steps)

2 Autumn 2021 Budget

The Chancellor presented the Autumn Budget and Spending Review 2021 on 27 October.[20] The Chancellor did not mention the issue in his statement, but the Budget Report confirmed that the Government would introduce legislation to reform the rules for income tax basis periods with effect from 6 April 2024.[21]

Provision to this effect is included in the Finance (No.2) Bill 2021-22 – which was published on 4 November; specifically clauses 7-8 of the Bill.

2.1 Impact assessment of the new rules

HMRC's impact assessment sets out the Government's objective for reforming these rules …

> The reform aims to create a simpler, fairer and more transparent set of rules for the allocation of trading income to tax years. This reform will remove all existing requirements of the basis period rules such as double taxation of early years of trading profits and maintaining accurate records of overlap profits and relief, which are often lost and not utilised by taxpayers.
>
> At present, two businesses that are identical except for their accounting date may have very different taxable profits for a tax year. The tax year basis will remove this difference, leading to fairer outcomes between businesses. Businesses with non-tax year basis periods currently experience double taxation in early years of trading, with relief generally given on cessation. Using the tax year basis will remove this complexity and lead to a clearer and more transparent relationship between the profits arising in a tax year and the tax liability related to them.
>
> All other forms of income are taxed on a tax year basis for individuals, including property income, interest and dividends. This policy aligns trading income with these other forms of income. For businesses that do not draw up their accounts to 31 March or 5 April, introducing the tax year basis for trading income will bring the payment of tax closer to the time that profits are earned. This will make it easier for businesses to save for their tax obligations, improve compliance, and reduce tax debt write-off. Bringing the payment of tax closer to the time profits are earned will also make the Income Tax system more responsive, giving effect to changes in

20 HC Deb 27 October 2021 cc273-287

21 Autumn Budget and Spending Review 2021, HC 822, October 2021 p147

> rates and rules sooner for self-employed people and allowing any future support to be better targeted.[22]

HMRC's impact assessment goes on to set out the current law …

> The current law on the taxation of trading income, including basis periods, is in Part 2 of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA). The law currently provides for tax to be charged on the profits of a trade (including a profession or vocation) of the tax year, and that the profits of the tax year are the profits of the basis period of the tax year.
>
> The current law on basis periods is in Chapter 15 of Part 2 of ITTOIA.

… and how this will be revised:

> Legislation will be introduced in Finance Bill 2021-22 to amend Part 2 of ITTOIA. This will remove the references to basis periods and provide for the profits of a tax year to be the profits arising in that year, in the same way as property and other income.
>
> The rules which currently require apportionment of profits to basis periods will instead require apportionment of profits to tax years. There will be equivalence rules for businesses with accounting dates between 31 March to 5 April to prevent these businesses having to apportion small amounts of profit.
>
> Legislation in Finance Bill 2021-22 will also introduce special rules for the transition year in 2023 to 2024. The basis period for the year will be the 12 months from the end of the basis period from 2022 to 2023, plus a transition component running from the end of this 12 months to 5 April 2024. Any overlap profits brought forward and/or generated will be relieved in full in 2023 to 2024 and not carried forward into the tax year basis.
>
> For businesses with higher profits in 2023 to 2024 due to the change in basis, the government is legislating to automatically spread the transitional period additional profits over a period of five years. The government is also legislating to allow a business to elect out of spreading and accelerate the charge, to treat additional amounts as arising in the tax year. The draft legislation published on 20 July 2021 will also be revised to reduce the impact of transition profits on allowances and benefits, alongside other changes.[23]

[22] HMRC, Basis period reform, 27 October 2021

[23] HMRC, Basis period reform, 27 October 2021

2.2 Impact on tax receipts

It is estimated that the measure will increase tax receipts by £820m in 2024/25, falling to £510m in 2025/26 and £360m in 2026/27.[24]

The Treasury's Policy Costings notes that, "these Exchequer impacts are largely a timing effect as the additional tax liabilities in the transitional tax year would have been due in future years if the sole traders and partners changed their basis period or ceased trading. The measure is broadly revenue neutral over the long term."[25]

In its Economic and Fiscal Outlook published alongside the Budget the Office for Budget Responsibility comment on this forecast:

> The measure **'income tax: basis periods reform for the self-employed'** relates to tax rules for partners and the self-employed, and the timing of when their income is assessed by HMRC. It effectively brings forward the point at which profits are assessed for tax purposes, boosting receipts by £0.8 billion in 2024-25, and generating £1.8 billion in total during the scorecard period, and by diminishing amounts through to 2028-29 (based on the policy's five-year 'transition period').
>
> It does not affect the underlying amount of profits that will be taxed, and indeed by removing the possibility of 'overlap relief' going unclaimed, reduces revenue overall. This measure therefore generates the 'fiscal illusion' of raising revenue when in fact it in the long term it reduces it. [26]

2.3 Further comment on Basis Period Reform

In a short piece on this annoucement Taxation magazine quoted Pete Miller, the chair of the CIOT's owner managed business committee, as noting that there would continue to be impacts on businesses in 2027/28 and 2028/29, "so the overall impact could be over £2bn", adding "this is a significant acceleration in the amount of tax revenues flowing into the Exchequer."[27]

At Treasury Questions on 2 November Pat McFadden characterised this measure as "a stealth tax on the self-employed of £1.7 billion over the next few years" and asked the Chancellor "why are the self-employed now being hit with this extra tax rise, which he did not even mention in his Budget speech last week?" The Chancellor responded to this point saying "there were no extra taxes for the self-employed in last week's Budget; the right hon.

[24] Autumn Budget and Spending Review 2021, HC 822, October 2021 p137 (Table 5.1 – item 60)
[25] HMT, Autumn Budget and Spending Review 2021 Policy Costings, October 2021 p58
[26] Office for Budget Responsibility, Economic and fiscal outlook, CP545, October 2021 para A35
[27] "News: Chancellor confirms basis period reform", Taxation, 4 November 2021

Gentleman may be referring to a timing difference that was reflected in the Budget scorecard of previously announced policies."[28]

HMRC's impact assessment provides some details of the anticipated impact on businesses (**emphasis added**):

> This measure is expected to have a significant impact on all self-employed traders and partners with trading income who do not currently draw up their accounts to 5 April or 31 March. There are an estimated 528,000 sole traders and partners with non-tax year basis periods. The measure simplifies the method for allocating trading profit to specific tax years, removing the existing complex basis period rules and replacing them with a much simpler method, taxing profits arising during the tax year. Responses to our consultation have suggested that this measure will improve the simplicity of the tax system for small businesses.
>
> One-off costs could include familiarisation with the changes and could also include updating software and guidance to remove the current basis period rules. These costs could also include one-off costs incurred by businesses who wish to move their accounting date to 31 March or to 5 April.
>
> Continuing costs could include the cost of the administrative burden of estimating profit figures for a small proportion (approx. 4% of sole traders and 17% of partners), and of submitting amended returns to provide final figures after the filing deadline. We estimate that this will affect approximately 278,000 sole traders and partners. The population affected is likely to be lower than these estimates when the tax year basis starts, as we expect many businesses to change their accounting date when the measure is introduced.
>
> The measure will also bring forward tax calculations that would otherwise have happened at cessation or on a change of accounting date. For these calculations, associated administrative costs are assumed to be mostly brought forward from future years rather than being additional costs to businesses.
>
> Continuing savings include sole traders and trading partnerships no longer having to familiarise and apply the basis period rules, not having to notify HMRC on a change of accounting date, and not paying tax twice on the same profit without claiming corresponding relief. They would no longer have to inform HMRC of their basis period or calculate and record overlap relief carried forwards in Self-Assessment tax returns. Businesses will no longer risk failing to use their overlap relief if they mislay their records of it, which may date from many years previously. **One-off costs on transition are expected to be negligible, and the measure creates a continuing administrative cost saving for businesses.**

[28] HC Deb 2 November 2021 c738

HMRC's assessment put the continuing administrative cost saving for businesses at £1.1m a year. The CIOT's Pete Miller has expressed some scepticism with these estimates:

> "The impact assessment published today recognises that there will be one-off costs for businesses including familiarisation with the rules, updating software, and deciding whether to change their accounting date to 31 March or 5 April. However, the estimated cost of this is considered to be negligible, which we think is unrealistic.
>
> "The continuing annual costs are estimated to be £9.1m; this will be mainly the additional compliance involved for those businesses for which it will not be commercially practical or possible to change their existing accounting date. However, the ongoing savings are estimated to be £10.2m, meaning that the overall impact is a negative £1.1m. Given the additional ongoing compliance and administrative burdens that we believe affected businesses will suffer to comply with the new rules, we find it hard to believe that these are outweighed by savings elsewhere."[29]

Following publication of the Finance Bill, representations on this reform were published by the Chartered Institute of Taxation (CIOT), the Association of Tax Technicians (ATT), and the Low Incomes Tax Reform Group (LITRG). Short extracts from each of these are reproduced below.

In their submission the CIOT suggested that businesses that did not adopt a tax year accounting period end will incur extra costs year-on-year:

> We welcome the government's deferral of the start date for basis period reform until 2023/24. This should allow for more consultation on some aspects of the rules, greater understanding of the wider impacts of the change (including the interaction with Making Tax Digital for Income Tax SelfAssessment), and a longer lead in time to allow businesses, agents and HMRC sufficient time to prepare.
>
> We are concerned that the measure replaces the complexities of the current regime with different (and potentially greater) complexities for the minority of businesses for which there are commercial obstacles to adopting a tax year accounting period end and that these complexities will arise on an ongoing basis meaning that costs and administrative burdens for those businesses will increase permanently as a result.
>
> The new rules will require such affected businesses to submit tax returns every year containing provisional (estimated) figures. We welcome that the government has committed to exploring how the burden of doing this might be eased. This exercise should be undertaken in a transparent manner as a public consultation.

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29 CIOT press notice, Go ahead for self-employed tax reform signals £1.7 billion tax grab for Treasury, 27 October 2021

> It is important that the changes and their impact are communicated clearly in advance to businesses which will be affected by the transition to the new rules.[30]

In their submission the ATT argued that the 12-month delay to the implementation of basis period reform might not be long enough:

> Whilst this reform may remove some of the complexities of the current basis periods regime, especially for new businesses, it will bring increased complexity, administrative burdens and costs for the minority of businesses who do not draw their accounts up in line with the tax year. HMRC need to focus efforts on limiting the practical impact on these businesses as much as possible.
>
> Whilst we welcome the government's decision to defer this reform until 2023/24, we remain concerned that it will take effect just a year before the introduction of Making Tax Digital for Income Tax Self-Assessment. The introduction of two large reforms to income tax calculation and reporting in the space of two years will place a significant burden on all involved. We have serious concerns as to whether taxpayers, agents and HMRC will be able to cope.
>
> HMRC must be adequately resourced to support taxpayers and their agents throughout this time. HMRC have recently acknowledged a six-month backlog of work which has resulted from the heavy demands placed on the department as a result of Brexit and operating the various Covid schemes. These additional changes will add to the burdens of both taxpayers and HMRC.[31]

The ATT also noted that some businesses may be unwilling to change their accounting date:

> Whilst some businesses may be able to change their accounting date to align with the tax year, and therefore remove some of these burdens and costs, this may not be commercially possible or desirable for some. For example, farmers often choose a year-end other than the tax year, as a spring year end would fall at a bad time for lambing, crop valuation etc. Other industries likely to be affected include retail and hospitality (who may prefer a year end away from the busy Easter period) and large professional partnerships who are part of international networks.[32]

As discussed in the next section of this briefing, in December the House of Lords Economic Affairs Committee's Finance Bill Sub-committee completed an inquiry which looked at this issue, in the context of the draft provisions for the Finance Bill published in July.[33] The Committee held a series of evidence

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30 CIOT, Basis Period Reform: Clauses 7-8 and Schedule 1, 23 November 2021 (Executive summary)

31 ATT, Clause 7 and Schedule 1: Abolition of basis periods, 23 November 2021 (Executive summary)

32 ATT, Clause 7 and Schedule 1: Abolition of basis periods, 23 November 2021 para 2.3

33 House of Lords Economic Affairs Committee press notice, Finance Bill Sub-Committee investigates basis period reform and uncertain tax treatment, 16 September 2021

sessions in October, prior to the Autumn 2021 Budget and the publication of the Finance Bill 2021-22, and at one of these on 21 October Malcolm Gammie QC (Member, Tax Law Review Committee), and Bill Dodwell (Tax Director, Office of Tax Simplification), addressed this specifc issue:

> **Baroness Kramer**: Would it be accurate to say that there are a lot of businesses in the hospitality and tourism sector, and indeed a lot of the retailers, that, particularly because of their business cycle, choose to have a different year-end? Are we looking at the very groups that have been greatly whacked by the whole Covid experience having more a more difficult challenge?
>
> **Bill Dodwell**: Yes, and I would put in agriculture. An awful lot of farming businesses do not use 31 March as year-end. Some do, but an awful lot do not because they want to know what sort of harvest they have. It does not make sense to draw up your accounts on 31 March when your crops are still in the ground and you have no idea how to reasonably value them. You do not know what the weather effect will be and all that sort of thing. Yes, lots of businesses use these things for perfectly sensible commercial reasons.
>
> **Baroness Kramer**: I just wondered, Mr Gammie, if you thought that the timetable of change was too tightly packed for us to make change.
>
> **Malcolm Gammie**: Certainly when the original proposal was made it struck me as amazingly short, particularly looking back. I was involved in the move to self-assessment in the early 1990s. That was a process, although maybe a larger process, that took five, six or seven years from beginning to end to work it out. It seems to me that you need these longer periods, particularly for the reasons that Mr Dodwell identified.
>
> A lot of these businesses are in retail, which traditionally have 31 January year-ends, or in farming and so are tied to their particular crops or the like, and professional partnerships, which are frequently governed by international considerations. Australia has a 30 June year-end for its tax year and America has 31 December, as Mr Dodwell indicates. All these things take a huge amount of planning and software adjustment to be able to deal with them.[34]

Finally, in their submission the LITRG also raised concerns about the timetable for reform, and suggested that MTD for Income Tax should be delayed an extra year:

> The existing rules on basis periods are complicated and difficult to understand and apply for low-income unrepresented taxpayers. These complexities will be removed under these proposals, making it easier for such taxpayers to understand their tax position from the outset and

[34] Finance Bill Sub-Committee, Oral evidence: Draft Finance Bill 2021-22, 21 October 2021 Q31. For a technical discussion of the implications of basis period reform for farmers see, "Farming peculiarities", Taxation, 9 December 2021.

> 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.[35]

2.4 Finance (No.2) Bill 2021-22

As noted, provision to the reform basis period rules is made by clauses 7-8 of the the Finance (No.2) Bill 2021-22; these clauses were among those selected for debate by the Committee of the Whole House on 1 December.

Speaking for the Opposition James Murray noted that those affected by the reform “will have to decide whether to change their accounting period end in 2023-24”:

> To make such a decision, it is important that they have the right level of support from HMRC at the right time. I would therefore welcome the Minister’s explanation of what support will be in place specifically to help people with their response to these proposed changes. We want to be

[35] LITRG, Finance Bill 2021-22 - Clauses 7-8 and Schedule 1 - Abolition of basis periods, 23 November 2021 (Summary). For a discussion of the practical implications for businesses see, “Shaking the foundations”, Taxation, 2 December 2021.

> reassured that support will be in place, that the traders who need that support most can get it and that the changes are fair.[36]

Speaking for the Liberal Democrats Christine Jardine raised concerns about the impact of the reform on farming businesses:

> Hidden in it are huge accounting changes that will make life much harder for tens of thousands of farming businesses, and other partnerships and sole traders around the country. Under the basis period reform, farmers will have to submit two tax returns instead of one, doubling their administrative burden …
>
> We would like Ministers to put those plans on hold immediately and listen to farmers' concerns. They should at least offer them an extended deadline, so that they do not have to estimate their profits but can submit just one final tax return. They should also explore the options laid out by the Office of Tax Simplification about changing the tax year to a 31 December end date. Farmers across the country have already seen their basic payments cut by at least 5% and could be facing even more costs.[37]

In response to these points the Financial Secretary, Lucy Frazer, said the following:

> The hon. Gentleman [James Murrary] asked me a specific practical question on what support will be provided to traders who are affected by basis period reform, and I am very pleased to get back to him on that. I would like to reassure him that more than 80% of affected businesses are represented by a tax agent, but HMRC is currently exploring how best to help unrepresented taxpayers through basis period reform …
>
> The hon. Lady [Christine Jardine] also mentioned the abolition of basis periods, and our basis period reform, and one of the first decisions I made as Financial Secretary to the Treasury was to extend the period before we bring in that measure, to ensure that everybody is ready for it. The measure has considerable support among stakeholders.[38]

In turn these provisions were agreed, unamended, without a vote.[39]

2.5 The House of Lords Finance Bill Sub-Committee

As noted above, it is common practice for HMRC to publish draft legislation for the forthcoming Finance Bill on 'L-Day', several months before the Budget.

36 HC Deb 1 December 2021 cc968-9
37 op.cit. c972
38 op.cit. c974
39 HC Deb 1 December 2021 c979

For many years the House of Lords Economic Affairs Committee's Finance Bill Sub-committee had an inquiry on selected measures in the draft Bill – focusing on technical issues of tax administration and whether the relevant draft legislation could be clarified or simplified.

On 16 September the Committee launched its inquiry on the draft Bill, announcing it would focus on two areas: the notification by large businesses of uncertain tax treatment, and, the proposals for income tax basis period reform.[40] The Committee held a series of evidence sessions in October, prior to the Autumn 2021 Budget, including one session with HMRC officials on 28 October. On this occasion the Chair, Lord Bridges, asked what the rationale for basis period reform was, in the context of concerns raised by the Law Society:

> **The Chair**: … I would like to read you what the Law Society of England and Wales has said about this. It said, "We are not convinced the case has yet been made for this reform. If it proceeds, there should be a coherent plan addressing the various interlocking initiatives of relevance to these proposals". Can you explain to us, in a nutshell, the rationale for this and how it will make our tax system simpler?

In response to Lord Bridges' first question Bridget Micklem (Deputy Director, Business Profits, HMRC) argued the basis period rules "creates disproportionately high tax burdens for new businesses and leads to many thousands of errors a year":

> You will have heard from lots of experienced tax professionals and sophisticated businesses who say that they find the basis period rules very easy to understand, but when we speak to small business advisers about the current system, they tell us that their clients just do not understand. One of them said to us, "When you try to explain the basis period rules, you get them lost before you even start". Our internal data confirms that. The level of confusion, the level of errors, the fact that more than half of eligible businesses leave overlap relief unclaimed suggests there is a big confusion here …
>
> We recognise—and this is what the Law Society is getting at—that there are some businesses that will face new issues if you move the system to a tax year basis. … The difficult judgment for government is how to make the simplification and maximise that benefit for the greatest number of taxpayers and then try to mitigate the potential issues that arise from the reform. The consultation that we have just had showed that it is clear that there is a wide cross-section of people who do see the simplification benefits. Some of the things that have already been announced in the Budget and things that will come in the legislation that we have signalled will be welcome in terms of the changes we have made to the policy.[41]

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40 House of Lords Economic Affairs Committee press notice, Finance Bill Sub-Committee investigates basis period reform and uncertain tax treatment, 16 September 2021

41 Oral evidence: Draft Finance Bill 2021-22, 28 October 2021 Q59

Lord Bridges went on to ask whether it was “critical that this takes place before Making Tax Digital.” Thomas Brown (Senior Policy Adviser, HMRC) replied to this question:

> Under the current Making Tax Digital for Income Tax regulations, which were laid in September, the quarterly reporting period—the regular reports that taxpayers make—runs over the course of the tax year. However, the assessment of tax, so the basis periods under the old rules, are not aligned to that tax year.
>
> For example, someone with a 30 April accounting date would essentially see 11 months of their assessable profits, of their assessable period, fall out of the MTD quarterly reports for that tax year. That creates fundamental misalignment within the old rules between the reporting periods and the period of assessment.
>
> What the basis period rules and basis period reform do is align the reporting under MTD with the assessment of tax and mean that quarterly updates can be used, for example, as a better indicator of how much profit somebody has made over the tax year and how much tax they might have to pay.[42]

At a later stage in the session Baroness Kramer asked whether HMRC would provide support for specific sectors that would particularly affected by the reform, such as farming and tourism:

> **Baroness Kramer:** … If I understand this essentially [entities that will have to apportion and estimate their profits] .. fall into two categories. We have some very sophisticated partnerships that will not be changing their year-end. They cannot because they are global, but they have a lot of internal resource and a lot of capability to deal with all these issues. I do not know if you have any comment on them.
>
> Then there is a pool of far less sophisticated companies—farming, tourism, some aspects of retail—that have very variable profits from year to year and very little control over that variation in profits, which are very hard to estimate. Because of their cash flow cycle, if they are paying tax against estimated profits, presumably they will have to borrow in order to make those payments, never mind get themselves a lot more complex advice. What will happen to provide them with some support, or are they just one of the groups that fall into the category of losers with this change?
>
> **Bridget Micklem**: This is where we have the problem of being “betwixt and between”, because I cannot anticipate all the things that will be said in the government consultation response. All we can say is that we take that seriously …

42 ibid.

> **Thomas Brown**: I would also reinforce the point that the tax year basis and the basis period reform are additional administrative burdens, which may be a cost to some of these businesses, but the old basis period system had an administrative burden, an administrative cost, of recording and of calculating overlap relief, and a real direct tax cost in businesses having to pay the overlap tax and then having to wait 10 to 20 years, for example, in the case of farmers, to be able to claim that relief back, by which point the relief will have lost most of its value. Under the old system, where you have a direct tax cost and an admin burden, the new system has an admin burden, so you are removing that direct tax cost.[43]

The Committee published its report on 15 December, making three recommendations regarding basis period reform:

> The Sub-Committee:
>
> - Considers the consultation on basis period reform as flawed. It is unclear why four years after the original consultation the new and different basis period reform proposals were published in haste.
> - Welcomes the Government's recognition that further work needs to be done on the impact this reform will have on businesses which cannot align their accounting periods with the tax year.
> - Recommends that, for those businesses which do not have a 31 March–5 April year end, Making Tax Digital should be deferred until at least 2025-26.[44]

The Committee did not consider that the Government had made a compelling case for basis period reform "either as a simplification or as an essential prerequisite for introducing MTD for tax." An extract from the report on this point is reproduced below:

> The consultation document placed basis period reform in the context of the roll-out of MTD and the Government's ten-year strategy for the administration framework. A call for evidence published in March 2021 mentioned basis period reform as an "example of a simplification opportunity". Basis period reform might therefore be expected to be followed by further changes as part of the Government's modernisation programme.
>
> [The London Society of Chartered Accountants Taxation Committee (LSCA)] said that basis period reform was "by no means a necessary element" of the Government's ten-year strategy and indeed the reform "could be considered counter-productive" insofar as the aim of the strategy was to

43 Oral evidence: Draft Finance Bill 2021-22, 28 October 2021 Q71

44 House of Lords Economic Affairs Committee press notice, Lords committee publishes report on Basis Period Reform and Uncertain Tax Treatments, 15 December 2021. See also, CIOT press notice, CIOT shares Lords Committee's worries about tax reporting reform, 15 December 2021, and LITRG press notice, House of Lords Committee- Basis Period Reform, 16 December 2021

provide a better experience for individuals and businesses. Susan Cattell, Head of Tax Technical Policy at the Institute of Chartered Accountants of Scotland (ICAS), said that if the Government did not proceed with full basis period reform a "partial" reform remained essential. The proposal to treat profits of accounting periods ending between 31 March and 4 April as profits of the tax year ("equivalence") was "particularly important" for property businesses.

Professional bodies that support small businesses or unrepresented taxpayers told us that they would find the new basis period rules easier to understand. The LITRG commented that one effect of the reform would be to encourage new businesses to choose either 31 March or 5 April as their accounting date and that "this will help those who are newly self-employed to better understand their tax affairs from the outset". It acknowledged that the changes "may increase complexity for some larger (likely represented) businesses, or those who need an alternative accounting date for commercial reasons". The Association of Taxation Technicians (ATT) on the other hand noted that the current rules are "familiar to many" and that "once a business is established they are fairly straightforward and logical to apply in practice" but added that "we appreciate that applying the current rules may be more complex for the unrepresented taxpayer".

Nonetheless, the Law Society of England and Wales (LSEW) said that "The practical consequences of the reforms … imply significant added complexity rather than useful simplification." Richard Wild of CIOT agreed: "We do not see this as a real simplification. It seems to us to trade one set of complexities that arise on fairly one-off occasions for those that occur on an ongoing basis year in and year out." Bill Dodwell of OTS summarised his view that: "The disadvantages of the plan outweigh any of the possible advantages, generally."

HMRC suggested that it was necessary to introduce basis period reform in advance of Making Tax Digital. Bridget Micklem, Deputy Director, Business Profits at HMRC told us that "the Government [has] consistently said that we need this reform before Making Tax Digital for Income Tax Self-Assessment comes in. That was the general view of stakeholders and people we were talking to before the consultation. People said to us, 'You need to do something about basis periods before Making Tax Digital starts'. This is a sequencing point that has been fairly clear all the way along, which is that you do not want to hardwire in complexity and all the difficulties that the current rules have into the Making Tax Digital system. You need to sort the tax code out first."

Rebecca Benneyworth of the Administrative Burdens Advisory Board (ABAB) told us that if basis period reform did not go ahead: "I cannot honestly see that it will disrupt MTD … but I understand that the idea is about smoothing the way." On the other hand, the Institute of Chartered Accountants in England and Wales (ICAEW) said: "Introducing basis period reform would appear to be unnecessary to make MTD ITSA [Income

> Tax Self-Assessment] work, other than to encourage businesses to transition to tax year end accounting." Bill Dodwell of OTS went further and said: "Not having basis period reform would make it much easier to land successfully Making Tax Digital for income tax."[45]

To date the Committee has not published the Governments' response.

[45] Economic Affairs Committee, Basis Period Reform and Uncertain Tax Treatments, HL Paper 128, 15 December 2021 para 25, paras 19-24