ICAEW
REPRESENTATION 77/21

BASIS PERIOD REFORM

Issued 27 August 2021

ICAEW welcomes the opportunity to comment on the consultation on Basis Period Reform published by HMRC on 20 July 2021, a copy of which is available from this link.

ICAEW supports any simplification of income tax ahead of Making Tax Digital for income tax self assessment (MTD ITSA). However the proposed reform of basis periods does not achieve this objective. This is a major change and we are concerned it is being rushed through without adequate consultation or detailed consideration of the many issues which it raises.

We appreciate that there was previously a short informal consultation with a range of businesses and tax experts and that there was support for the general principle. However, we are disappointed that when the consultation was announced, the government stated that it intended to implement the proposed reform ahead of mandating MTD ITSA. Subsequent consultation with our members and other stakeholders has made it clear that there is little support to proceed with this proposal. While superficially it may result in some simplification of the tax system, in practice it is likely to create as many problems as it might solve.

Many businesses have to adopt a particular year end for commercial reasons. Such businesses are now likely to face increased costs and uncertainty due to the need to use estimated figures in their tax returns. The whole point of the current system is to provide taxpayers with certainty when they submit their self assessment return – this will be a retrograde step.

In summary, while the idea had some attractions initially, on further consideration we do not see it will provide any substantive simplification benefits to the UK tax system, is likely to increase costs, complexity and uncertainty for those businesses affected and could damage the UK's attractiveness as a place for the location of international service firms.

As the UK recovers from the pandemic, the one thing businesses need most of all is a period of certainty and stability.

Now is not the time to make this change. We urge the Government to drop this proposal.

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This response of 27 August 2021 has been prepared by the ICAEW Tax Faculty. Internationally recognised as a source of expertise, the faculty is a leading authority on taxation and is the voice of tax for ICAEW. It is responsible for making all submissions to the tax authorities on behalf of ICAEW, drawing upon the knowledge and experience of ICAEW's membership. The Tax Faculty's work is directly supported by over 130 active members, many of them well-known names in the tax world, who work across the complete spectrum of tax, both in practice and in business. ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark the tax system and changes to it, are summarised in Appendix 1.

ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of strong economies, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 157,800 chartered accountant members in over 147 countries. ICAEW members work in all types of private and public organisations, including public practice firms, and are trained to provide clarity and rigour and apply the highest professional, technical and ethical standards.

KEY POINTS

Summary of concerns

1. This is a major change and we are concerned it is being rushed through without adequate consultation or detailed consideration of the many issues which it raises.
2. We appreciate that there was previously a short informal consultation with a range of businesses and tax experts and there was support for the general principle. However, we are disappointed that when the consultation was announced, the government stated that it intended to implement the proposed reform ahead of mandating Making Tax Digital for income tax self assessment (MTD ITSA). Subsequent consultation with our members and other stakeholders has made it clear that there is little support to proceed with this proposal. While superficially it may result in some simplification of the tax system, in practice it is likely to create as many problems as it might solve.
3. Our key concerns can be summarised as follows:
   - If 93% of sole traders and 67% of partnerships already use, in effect, a tax year basis, then for all those businesses there is no simplification.
   - The businesses which will be affected by this change, which although a minority is still a considerable number, are likely to be larger businesses and/or to have good reasons for using a particular accounting date. For these, the complications of this change and the transitional rules are likely to cause considerable disruption.
   - Many businesses have to adopt a particular year end and many businesses with international connections will be using a 31 December year end. Such businesses are now likely to face increased costs and uncertainty due to the need to use estimated figures in their tax returns. The whole point of the current system is to provide taxpayers with certainty when they submit their self assessment tax return – this will be a retrograde step.
4. In summary, while the idea had some attractions initially, on further consideration we do not see it will provide any genuine simplification benefits to the UK tax system. Further, it is likely to increase costs, complexity and uncertainty for those businesses affected and could damage the UK's attractiveness as a place for the location of international service firms.
5. As the UK recovers from the pandemic, the one thing businesses need most of all is a period of certainty and stability. We are already facing a seismic change to the UK tax system in the form of changes introduced by MTD ITSA which will require a huge change in the way many businesses prepare their accounts and undertake their tax compliance. This will require a major communications exercise with taxpayers and unprecedented support from HMRC and the tax profession. The last thing businesses need now is yet more complexity and uncertainty which would result from these proposals.
6. Now is not the time to make this change. We urge the Government to drop this proposal.

Consider a more holistic approach to change

7. We support simplification and in particular simplification of income tax ahead of MTD ITSA however the proposed reform of basis periods is being introduced far too quickly.
8. We believe that this pace of change is unnecessary and is counterproductive, but that implementation would be more successful if more time was taken for agents, taxpayers and HMRC to adapt to the changes.
9. We consider that HMRC should consider any change on an holistic basis in the context of other discussions currently taking place on the future of personal income tax. We suggest the following direction of travel:
   - The ideal would be to begin by considering the tax year end following the Office of Tax Simplification's findings which will be available this autumn. If the conclusion is to recommend change, there could be no need for an equivalence rule to be included in the basis period reform proposals. We note that a change to 31 March would achieve this, while a change to 31 December would bring the UK into line with most of its international

partners and would make tax calculations for those with overseas income and gains considerably more straightforward and accurate. However, it has been made clear by Government Ministers, Treasury officials and HMRC that to wait until the tax year end conundrum has been resolved would be to put back the MTD proposals for years which would also delay the move to digitalisation by business.

- We suggest instead that any reform should be focussed around a staged introduction of MTD ITSA. It is our view that requiring all businesses to start from April 2023 with the first reports being due on 5 July is highly unlikely to be capable of success.
- Considering basis period reform in the context of these other changes leads to different conclusions. We recommend that the following changes would place the needs of business as the driver for change and would allow agents to help their clients to adapt more successfully to MTD ITSA in the first instance:
  - the default accounting date for all new businesses should be 31 March for ITSA with an option to elect for a different date where there are commercial reasons.
  - property income should be required or permitted legally to be reported to 31 March, instead of 5 April.
  - businesses which change their accounting date to 31 March in the period between now and the start of MTD ITSA should be allowed to spread the resulting additional profits in the manner described by the basis period consultation.

13. We believe that the likelihood of a successful transition and ongoing compliance will be improved if the changes are enacted by statute and the rules are certain, simple and clear, tax liabilities are simple to calculate and cheap to collect, and the government allows adequate time for consultation, drafting and consideration by Parliament of the legislation, and implementation. These objectives are drawn from our Ten Tenets for a Better Tax System by which we benchmark the tax system and changes to it, summarised in Appendix 1.

Interaction with MTD ITSA

14. The interaction between basis period reform as set out in this consultation and the start date for MTD ITSA needs to be much more carefully thought through.
15. We understand that one of the implications of the proposals is that ALL businesses may be required to start submitting MTD ITSA quarterly reports from the quarter commencing 1 April to 6 April 2023.
16. Based on the published draft MTD regulations, the start date would have varied depending on a businesses' accounting date. For all businesses except those with a 5 April year end, this proposal for basis periods will bring forward the date from which MTD ITSA will apply for most. It will also mean that agents will not be able to bring their clients into MTD ITSA spread more evenly through the first year of its operation which would have helped them to deal with its introduction more successfully. Instead, the first quarterly updates from the more than four million businesses expected to be within the scope of MTD ITSA will all be due to be filed on one date, 5 August 2023, putting enormous pressure on businesses, software providers, agents and HMRC customer support.
17. In fact, the impact could potentially be even more serious. It is not clear how businesses that do not account to 31 March/5 April would finalise their trading income ie, whether end of period statement (EOPs) would be for an accounting period or a tax year and how the EOPs would flow into the finalisation of the tax liability for the relevant tax year or years.
18. Businesses will want to join MTD ITSA from the start of an accounting period to allow that accounting period to be wholly reported within MTD ITSA. Would businesses that join mid-accounting period need to submit 'catch-up' quarterly updates back to the start of the accounting period? If so, businesses with an accounting date other than 31 March to 5 April might need to submit quarterly updates for quarters prior to April 2023. For example, a business with a 30 April accounting date might need to start recording transactions digitally from 1 May 2022 and submit a quarterly update for the period May to July 2022.

19. If this is so, the impact of MTD ITSA would be felt considerably earlier than its official start date and it is not clear that the pilot will be sufficiently advanced to allow businesses to join from the date that would be required.

20. Government will need to carry out a major publicity campaign to raise awareness about all these changes, especially for businesses which are currently anticipating having to join MTD ITSA some moths after April 2023.

Impact on agents

21. Even if the reforms are introduced at a more modest pace, many of our members have expressed considerable concern about the impact the proposals will have on their workloads. This is both in terms of the overall amount of work required (including multiple MTD ITSA reporting requirements and a tax year end reconciliation which is likely to be more complex for businesses without a 31 March to 5 April accounting date) and the bunching of work dictated by quarterly deadlines. Many members have indicated that they would being forward their planned retirement date. Practices are deferring hiring or expansion plans until the extent of the additional workload is more fully understood.

22. One of the most significant concerns is that all businesses would need to submit MTD ITSA quarterly updates to the same deadlines. This would result in considerable ‘bunching’ of work around July, October, January and April. One possible solution to this problem would be to extend the deadline for quarterly reporting from one month to two months after the quarter end. This would give accounting practices twice as much time to carry out the work they need to do to prepare their clients’ quarterly updates.

23. Another measure that would help to ease the pressure on agents would be to give them access to third party data received by HMRC on their client’s tax affairs so that this can be factored into quarterly updates and the end of year tax reconciliation.

24. Even if agents were able to manage the additional workload, they would need to increase fees by a considerable sum in order to reflect the additional work that is required. Many smaller businesses would find that employing an accountant would become unaffordable. They may attempt to comply with their tax obligations without assistance. They may rely on cloud accounting systems to give them the answers they need, without a sufficient understanding of bookkeeping. The result could be considerably less accurate returns and quarterly updates and result in more, rather than fewer, errors.

25. It is worth remembering that accountants do not just provide tax compliance services. They also help their clients with financial and business planning and give advice. Placing a huge burden on them to submit all MTD VAT and MTD ITSA returns and updates to the same deadline would reduce the capacity they would have to support clients in other ways during their busy periods.

Interaction with VAT quarterly returns

26. Agents and businesses will need to consider whether to change their VAT stagger group so that they align their VAT returns with their MTD ITSA quarterly updates. Feedback we have received from our members is that most businesses would want to make this change.

27. While such businesses would then only be working to four quarterly deadlines each year, it further exacerbates the ‘bunching’ of workloads issue referred to above and may lead to more errors and less accurate reporting if agents and their clients struggle to deal with the workload. There would also be a cashflow impact of this on businesses if they bring forward their VAT reporting and have net output VAT to pay to HMRC.

28. If businesses don’t change their VAT stagger groups, then they will still be working to eight quarterly reporting deadlines a year, plus the annual end of period statements for each trade and annual tax finalisation.

Exclusions

29. We understand that Lloyds Underwriters are to be excluded from the proposed basis period reforms. In addition, we believe that consideration should be given to excluding the following groups of taxpayers who are not in scope for MTD ITSA from April 2023:

30. **Trusts and estates**: As the motivation for introducing this reform is to make MTD ITSA work, we do not see any benefit in including trusts and estates, other than for the sake of consistency, as they are not expected to be within the scope of MTD ITSA for the foreseeable future.

31. **Partnerships with corporate partners and Limited Liability Partnerships (LLPs)**: These entities will not be required to join MTD ITSA from April 2023 and therefore we suggest that the basis period reform should not apply to them, or at least it should be deferred until MTD ITSA applies. Unlike sole traders, LLPs (particularly those with international connections) commonly adopt an accounting date different from the tax year (most often 31 December) and so would be more likely to be affected detrimentally by the proposals.

32. **Individuals applying the cash basis**: See our response to question 7. We recommend that cash receipts under the cash basis are the amounts actually received during the tax year, rather than during the accounting period(s) included in the tax year. This appears to be the effect of the draft legislation published alongside the consultation document.

ANSWERS TO SPECIFIC QUESTIONS

Question 1:

Do you think that the proposed 'tax year basis' for trading income is the best option for simplifying the basis period rules, and the best way to achieve simplicity and fairness between businesses? If not, do you think there is a better option?

33. It is difficult to see how mandating a tax year basis provides simplification for those business that already account on a tax year basis given that there is no change. A significant number of businesses will, for genuine commercial reasons, need to retain accounting dates that are different from 31 March to 5 April. This will create difficulties where the profits of the second accounting year within a particular tax year need to be estimated for annual tax return submission purposes. Further thoughts and ideas around these difficulties are set out below.

34. Other potential options for reform are considered below.

Mandating tax year accounting dates

35. Many businesses use a different accounting date for genuine commercial reasons and we do not believe that this option is fair to these businesses. Examples are seasonal businesses and businesses that are part of a larger international organisation (eg, international accounting and legal partnerships). Mandating tax year accounting would create very considerable difficulties for them, although this would be mitigated for many international businesses if the tax year-end were changed to the calendar year. Default tax year accounting with an option to elect for a different date would be an option.

36. As we set out below, a tax year basis of taxation will cause peaks of work for accountants following quarter ends; mandating tax year accounting would make this worse as bunching of work would be required both for accounting and tax reporting purposes.

Corporation tax like approach

37. While we can see the benefit to adopting a similar approach for unincorporated businesses as companies (especially as this would reduce the bunching of work around particular deadlines referred to below), there are fundamental differences to the way that the income tax and corporation tax systems work that would make this proposal difficult to adopt in practice. We believe that there is considerable merit to all unincorporated businesses working towards the same deadlines so that HMRC messaging and prompts can be sent to

all businesses at the same time. We also assume that a system which allowed a business to choose its own tax year would require considerable overhaul of HMRC's systems in order to cope with this. Complications would arise with allocating multiple personal allowances, tax bands etc across a single accounting year. Other forms of income received by the individual taxpayer concerned would continue to be taxed on a tax year basis which would introduce further complication, as would the calculation of National Insurance.

Question 2:

Will the proposed tax year basis have an effect on how businesses choose their accounting date, and whether they choose 31 March or 5 April?

38. An informal poll of our members confirms HMRC's conclusion that a large proportion of sole traders already adopt a 31 March or 5 April accounting date, though their experience suggests that in their client base the proportion is less than the approximate 93% mentioned in the consultation document.

39. It may be the case that accounting to 31 March/5 April predominates among the smallest businesses which are not represented by an agent. It would be helpful to see HMRC's data to assess the relative size of businesses with different accounting dates.

40. Our members anticipate that many businesses that do not already use an accounting date of 31 March or 5 April are likely to do so to avoid the need to estimate profits when establishing their tax liability, with a possible need to revise their liability at a later stage. We understand that some members already require new clients to use a 31 March or 5 April accounting date.

41. Some businesses have reduced profits due to the pandemic and consequently this may be a beneficial time for them to change their accounting date as the impact could be less than in a later year. However, the wording of the legislation is such that those who change their accounting date ahead of 2022/23 would not benefit from the transitional spreading relief. We recommend that this should be reconsidered and that additional flexibility be given so that businesses could decide to change to tax year accounting in 2021/22 and still benefit from the transitional rules. This relief should be considered even if the current basis period proposals do not go ahead.

42. Other businesses will retain or choose a different accounting date if there is a commercial reason for doing so There are significant one-off practical costs involved in changing a business' accounting date. Such costs might include reprogramming financial reporting systems, some of which may not actually permit a change of accounting date.

43. The following types of business are likely to find it particularly difficult to change their accounting date:

Seasonal businesses

44. Some tourism related businesses often avoid choosing a 31 March/5 April accounting date as it could fall in the Easter holidays, with some years potentially containing two Easters and some having none. Such businesses tend to have an accounting date between November and February when they are quieter.

45. Some businesses match their accounting period to the academic year as that fits with the annual cycle of their business.

46. Other businesses choose to have an accounting date at a time when their accounting year end work can be done more efficiently, perhaps when they know that their accountant is less busy so has greater capacity to provide advice and other services, perhaps at a cheaper rate when staff would otherwise be idle. If the outcome of the proposals is to force them to move their accounting date to 31 March or 5 April, or to move some of the work that would have been done at their accounting year end to a quiet period, this outcome could be at odds with the policy intent of a number of other measures under review by HMRC around raising standards in the tax advice market and supporting taxpayers to improve compliance.

Partnerships and other international businesses

47. UK businesses that are part of an international organisation (eg, accounting and legal partnerships and associations) may not be able to change their accounting date as this may be set by the head office or lead firm of the organisation. A representative from a large accounting firm has told us that approximately two thirds of their partnership clients fall into this category. Other businesses with key customers or suppliers based overseas may prefer to set their accounting date to one that is commensurate with the cash flows received or paid to them. Yet more international businesses have accounting dates that align with overseas tax years, which if the UK changed to a calendar tax year, would simplify tax compliance worldwide.

Agricultural businesses

48. We understand that many arable farming businesses prefer to have a 30 September year end so that they can calculate profits and count stock once they have collected in their main harvest for the year. Difficulties include bunching of work by valuers if all valuations are all needed for 31 March, at a time which is potentially the busiest time for the farmer as they deal with lambing or ground preparation and crop sowing.
49. Some businesses that do not account to 31 March/5 April may choose to incorporate to avoid the ongoing complexity of allocating accounting periods to tax years. There is a risk that some would incorporate for this reason alone without considering whether incorporation is appropriate for their business.

Question 3:

For businesses with a non-tax year accounting date, what would be the cost of the additional administrative burden of apportioning profits into tax years? Are there any simpler alternative approaches to apportionment?

50. Profit estimation and allocation of profits in accounting periods to tax years is likely to be the most significant ongoing additional cost such businesses would face as a result of these proposals. More details on this are included in our response to question 4b. This would impede a business' ability to plan in advance for future tax liabilities which was intended to be one of the main advantages of MTD ITSA.
51. In addition, such businesses are likely to need to amend their tax returns – preparing them initially on the basis of estimated profits and amending them when the final profit for the second accounting period in the tax year is known. If the reported profit based on estimates is lower than the final figure, additional tax and late payment interest would become payable, increasing not only compliance costs but also the overall tax cost to the business.
52. Many businesses choose an accounting date other than 31 March or 5 April for commercial reasons. Some members have told us that effectively forcing them to account to the tax year end is trying to apply a one-size-fits-all approach to taxation, rather than recognising that not all businesses are the same. For example, stock taking by agricultural businesses is not practically possible except in Autumn when the harvest is over.
53. A particular issue arises for doctors and other medical professionals, especially larger GP practices where the cost of accounts and tax returns are borne by the practice on behalf of the GPs. In addition, their superannuation certificates (prepared for the purposes of determining pensionable pay) would need to be amended to reflect the final tax position for each doctor, leading to a further additional cost for the practice. Other impacts on the medical profession are set out in our response to question 10.
54. Any system that requires a tax return to be submitted based on an estimate of the profits of an accounting period and before the results for that year are known, or even before that period has even, runs a high risk that it will be inaccurate, with amendments being required on a regular basis.
55. An apportionment based on actual results for the proportion of the accounting period falling in the tax year might be easier and quicker to calculate rather than waiting until the end of the

accounting period and then taking a pro-rata amount of the profit for that whole accounting period. The difficulty with this would be how to deal with accounting and tax adjustments, such as capital allowances.

56. We should welcome confirmation that no penalties will be levied on taxpayers that have made a reasonable attempt to calculate their anticipated liabilities for tax years by the reporting and payment deadlines and that the submission of an amended return does not restart the enquiry window clock.

Question 4a:

Businesses with accounting dates later in the tax year will have to estimate profits for a proportion of the tax year, before accounts are prepared. For which accounting dates do you think this would be necessary? Do you expect that businesses that have accounting dates earlier in the tax year than 30 September will have to estimate profits? If so, which types of business would be affected?

57. Some of our members have indicated that businesses with accounting dates as early as 30 April could need to use estimates if they have large or complex businesses for which accounting adjustments are required. If finalisation of the tax position is due on 31 January of the following year, this still only leaves 9 months for businesses with that accounting date.

58. Seasonal businesses in particular will have difficulty making accurate estimates of profits for a particular accounting year until considerable time has elapsed, especially where previous results are not a reliable indication of future ones. For example:
    - The success of the main crop for a farm is largely weather dependent.
    - Self-employed medical professionals whose sessions can change significantly month on month will also be affected considerably.

59. Businesses with a 31 December accounting date (the next most common after 31 March/5 April) will need to estimate profits.

Question 4b:

Will estimation be a significant burden for those businesses affected, and what will the cost be? Are there any simpler alternative methods of estimating profit or finalising estimates, which could mitigate any extra administrative burden?

60. The cost is not just the need to make an estimate, it is the need also to amend that estimate once the final figures are known.

61. For businesses that have an accounting date other than 31 March – 5 April, it is very difficult to assess the administrative burden without the final MTD ITSA regulations and a fuller understanding of how quarterly updates, end of period statements, tax year finalisation and amendments will fit together. The additional burden on partners is also unclear because how the amendments will flow from the partnership tax return to the partner's tax return will vary in complexity. See response to question 6 for more details.

62. It is also unclear whether HMRC would accept that the first tax finalisation submitted each year by taxpayers with accounting dates different from the tax year will inevitably include estimates and so hold off on raising enquiries until an amended return has been filed. While this would remove the stress of an enquiry during the period while the figures are not final, HMRC would inevitably want to restart the enquiry window from the date of submission of the amended return and so this would mean that taxpayers could not be certain that their returns will not be subject to an enquiry (unless through a discovery assessment) until much later than at present.

63. It might be possible to consider whether separate amendment windows could be set for each period of account in the tax year to enable earlier certainty over the first period of account.

64. Considering each of the alternative methods set out in the consultation document:

Estimates based on quarterly updates

65. This method results in the lowest upfront costs because there is no need to go through a separate process of re-estimating profits after quarterly updates have been submitted. However, it is likely to result in larger adjustments once the final tax position is known (as accruals and other accounting and tax adjustments are unlikely to be incorporated into quarterly updates). Therefore, this may result in late payment interest charges (or indeed repayment interest if initial estimates over-estimate quarterly profits).

Extrapolation of profits for earlier part of the year

66. This method is only likely to be appropriate for businesses that have fairly consistent profits throughout the year. It is unlikely to work for seasonal businesses.

Allowing the final figures to be provided as part of the next tax return

67. We are unclear about what this would mean in practice and would welcome clarification. If the proposal is that the income adjustments are included as positive or negative income in the following year then anti-avoidance provisions would need to be considered to stop income being shifted from one year to the next.

Question 5:

Would the proposed equivalence of 31 March to 5 April help businesses that would have to make apportionments to work out their profit or loss under the tax year basis? Would extending this equivalence to property income help property businesses, which would otherwise have to apportion profit or loss each year? Are there any problems with this equivalence proposal?

68. The proposed equivalence would undoubtedly help both trading and property businesses with a 31 March accounting date to calculate their profits more easily on a tax year basis. We understand that certain software products are not designed to allow for non-month end accounting dates but are not in a position to confirm details.
69. Our understanding is that many property businesses do in fact account to 31 March and report these figures on their self assessment tax returns, despite the legal requirement to report to 5 April. Allowing property businesses to account and report to 31 March is, in our view, the minimum change that needs to be made to accommodate MTD ITSA.
70. Many businesses require their period of account to end on a set weekday, for example the last Friday or Saturday in their accounting period, rather than on a set date, eg 31 March or 5 April. As there are seven days in a week but only six days in the proposed equivalence period 31 March to 5 April, we recommend that, if the tax year end is not changed to a calendar year, the equivalence period should be seven days from 30 March (rather than 31 March) to 5 April, to enable these businesses to comply with the new regime without the need for a non-statutory workaround.

Question 6:

Are there any specific issues, costs, or benefits to the tax year basis for partners in trading partnerships?

71. Partners in trading partnerships will not be able to finalise their personal tax returns until the partnership return has been prepared and the necessary information has been disseminated to the partners or their agents. If the initial return prepared by or for the partnership is based on estimates, this means that the individual partners will also be using estimates and so would not have certainty over their tax position until those estimates have been reviewed and amendments made.
72. When a partner joins a partnership part way through a tax year, they are taxed on their share of the profits from the date of joining to the end of the tax year. Just as when a business begins trading part way through a tax year, in their second year of membership of the

partnership they are taxed on their share of profits for the period ending in that second tax year. This makes estimating profits based on previous quarters unsatisfactory.

73. If the accounting period is different from the tax year, this creates overlap relief. However, that overlap relief will be different for each partner depending on the date in the tax year on which each joined the partnership. It can be quite burdensome for partnerships to maintain records showing the different overlap profits for each partner for each year. A move to the tax year end basis would use up any existing overlap relief and so would remove this record keeping burden. However, if accurate records have not been maintained then the partnership may not be able to inform each partner how much overlap relief they are entitled to. We understand from members that in practice this type of problem is likely to be more frequent than might be expected.

74. It would ease compliance and avoid HMRC needing to check and enquire into overlap relief used if HMRC could provide businesses and their agents with the figures for available overlap relief, including overlap relief on the change from preceding year to current year basis in the 1990s. We would strongly urge HMRC to build the provision of this information into its implementation plans.

Question 7:

Are there any other issues and interactions to consider for the tax year basis, or the transition, in the areas of tax outlined in paragraph 3.33?

75. We set out below some considerations and thoughts with regard to interaction with some of the areas of tax referred to in para 3.33 of the consultation document, along with some others.

Capital allowances

76. Currently capital allowances are calculated for a particular accounting period of a business. This means that, without reform, if a business had an accounting period that differed from the tax year, it would need to calculate the capital allowances position for two different accounting periods in calculating the overall position for a tax year. This could be particularly difficult, especially where the majority of the second period in the tax year has yet to elapse by the end of the tax year, as it would be dependent on an estimate of the total additions and disposals to be made for the whole of that period.

Cash basis

77. In general, the cash basis can only be claimed where the aggregate of the cash basis receipts of each trade, profession or vocation carried on by the person during the basis period ending in the tax year does not exceed £150,000. We recommend that this rule is changed to £150,000 cash receipts arising in the tax year to make this easier to determine.

78. If the proposed change to basis periods is introduced, we anticipate that many individuals with accounting year ends different from the tax year will choose to adopt the cash basis as it would mean that it is not necessary to estimate the profits of the second period arising in the tax year. If the individual subsequently fails to meet the qualifying criteria for the cash basis, they will need to have processes in place quickly to revert to accruals accounting and estimating accounting profits.

Personal pension contributions

79. Owners of businesses adopting an accounting period different to the tax year will not know their taxable profits for a tax year until after that year has finished. While this is always the case (unless the business owner is effectively performing a taxable profits calculation throughout the year), use of an accounting date different from the tax year would only make this worse.

80. It is the Government’s stated intention to incentivise taxpayers to make sufficient savings for their retirement through pension contributions. Such contributions have to be paid ‘in year’,

and only qualify for tax relief if they are within certain allowances and are covered by Net Relevant Earnings. So, for example if an individual paid a premium of £30,000 towards their pension but after the accounts for the year are completed and capital allowances claimed, they had profit of only £10,000 then £20,000 of the pension premium would not qualify and would have to be repaid or an additional tax charge paid.

High Income Child Benefit Charge (HICBC)

81. HICBC is already complex. Adjusted net income includes self-employed business profits and property income for those individuals who receive such income types. The charge needs to be paid at the time that the individual's self assessment tax return is due. If the return includes profit figures that are estimated, it may not be clear whether HICBC is due at that point. We therefore suggest that no penalties should be levied on individuals who fail to pay the HICBC before it is clear what is their net adjusted income.
82. In some cases it would also become more difficult to establish which member of a couple is the higher earner and therefore liable to pay HICBC. Amendments to the tax returns of either or both could change who is liable, as well as the amount of the charge.

Averaging profits

83. Farmers, market gardeners and individuals who create literary or artistic works are entitled to average their profits over two or five tax years. The claim is made at the end of the two or five year period and must be made before the end of the first anniversary following the normal self assessment filing deadline for the latest year to which the claim relates. Our opinion is that this should give sufficient time for the profits over the whole multi-year period to be determined before the claim needs to be made.

Income tax rates

84. Including transitional profits in the transitional tax year may push some taxpayers into a higher tax bracket for that particular year or increase their liability due to the high income child benefit charge, removal of marriage allowance, restriction of personal allowances or earlier student loan repayments. This may also affect entitlement to tax-free childcare support. Spreading the transitional profits over a five-year period would help to mitigate this outcome but may not do so in all cases. This could also have a knock-on effect on the rate at which capital gains are taxed.

Payments on account

85. It is important that payments on account of income tax due for a following year do not take into account any transitional profits spread into the current year. These profits are essentially transitional adjustments and bear no relation to the payment of tax on annual profits of the business concerned. HMRC's tax statements for tax paid by self assessment taxpayers will need to be made much clearer.

Claims and elections

86. Most claims and elections (eg, loss relief claims) have a deadline of the anniversary of 31 January after the end of the tax return to which the claim relates. Anything that delays the finality of the accounting figures will shorten the period of time available to determine whether an election should or should not be made, which may be detrimental to the taxpayer. Some deadlines may need to be reviewed.
87. Other issues that may need consideration include post-year adjustments to profits subject to income tax. This could happen for example where taxable profits change following negotiations on irrecoverable VAT in partial exemption calculations.

Section 4. Implementation and transition

Question 8a:

Does the proposed method of transitioning to the tax year basis using a long basis period combined with allowing all unused overlap relief achieve the best balance between simplicity and fairness? If not, is there a better option for transition?

88. We understand the government will not want any profits to escape tax as a result of implementing these proposals. Inevitably there will be an additional tax charge in the year of transition for those businesses with profit levels now that are higher than the profits made when the business first started trading and so generated overlap relief. The business may have grown and become more profitable but also time elapsed will have affected the value of that relief.

89. We are concerned that taxpayers could be required to use their overlap relief at a time that may not be advantageous to them, perhaps because there is a loss suffered in the year of the transition. We recommend that it should be possible for a business to choose instead to continue to carry forward its overlap relief and use it against profits arising in the year of retirement rather than in the year of transition. This is already possible for example after a change in accounting date.

90. We are also concerned that some businesses may not have an accurate record of their overlap relief and we suggest that HMRC's record should be made visible through the taxpayer's business tax account and also be made available to agents so that it can also be checked against the business' own records.

91. We note that there may be a number of reasons why a business or its agent does not have a record of overlap relief available including:
    - agents taking on new clients with an incomplete information handover from their previous accountants;
    - a change in software (or even paper returns) used during the last 20+ years since overlap profits were first introduced leading to a loss of data during the transfer; and
    - software errors such that carry forwards have not pulled across as they should have done.

Question 8b:

Are there any other specific circumstances on transition to the tax year basis that would require additional rules?

92. It is not clear from the draft legislation what happens if the business has a loss in the tax year of the transition. Further drafting is required to clarify this. We suggest that if there is a loss in the basis period ending in the transition year, or the next one, or both, the taxpayer could offset these against any profits in those years. Alternatively, these could be treated as nil and a statutory basis could be used to claim loss relief. Clause 38 only refers to the spreading of transition period profits, which suggests that if there are losses in that year that are greater than the losses that would have arisen otherwise, the difference is not spread. This needs clarification. Some taxpayers might prefer the option to spread this additional loss if it fits better with the use of such losses either through sideways loss relief or by carrying them backwards or forwards. We suggest that this be included as an option.

93. Particular issues would arise for businesses with overseas income and/or partnerships with overseas partners. These include the following:
    - how to give the overlap relief on transition where the overlap on creation included foreign tax credits;
    - how foreign tax credits will be treated where the transitional profit is spread over five years;
    - how apportioning tax liabilities for partnerships across tax years impacts on a tax adjustment for joiners and leavers who may be allocated profit for the whole fiscal year but are only partner in one tax year;

- for UK-resident members of related UK and overseas firms, where it is uncertain whether they will have sufficient UK profits in the transitional year to use the previously created overlap; and
- how non-resident partners will claim double tax relief on UK tax ‘spread’ profits.

Question 9a:

Would the proposals for spreading excess profit mitigate the impact of transition without affecting the simplification of moving to the tax year basis? If not, are there any other ways of mitigating the transition impact that you would suggest?

and

Question 9b:

Would the proposal to spread excess transitional profits over five years be enough to resolve the cash flow impacts of the proposed reform? Are there any situations which would need additional rules or anti-avoidance provisions?

94. We are answering these two questions together. We support spreading rules to help reduce the impact on tax liabilities of transitional profits. The UK tax system has included a number of precedents for spreading, including a ten year spreading on the move from a cash basis to an accruals basis (see s 52 and Sch 6, FA 1998) and up to six years on the adoption of UITF 40 (s 102 and Sch 15, FA 2006).

95. While we consider that five years is probably a sufficient period over which to spread, each case will depend upon the facts and we do not know for sure whether it will be sufficient to mitigate the cash flow impacts for most taxpayers . Obviously, a longer period (for example 10 years as introduced in 1998) would give businesses more time to pay the additional tax, but this needs to be weighed up against having the additional complexity of the need for the business to make a transitional adjustment for a longer period. We presume that the class 4 NIC position on these profits has yet to be considered.

96. We also note that individuals who decide to retire and cease trading part way through the spreading period will be required to take into account the balance of any remaining profit in the final tax year of trading. That also appears to be the case where the business is incorporated. While we see the logic behind this, we consider this may have a significant impact on the tax position of retirees and those disposing of or incorporating their businesses. This may cause them to pay higher rates of capital gains tax on the sale of any business assets, for example. In the interests of fairness, we consider that such individuals should be able to continue spreading any excess transition profits over the remainder of the proposed five-year period and be taxed on any remaining amounts as post-cessation receipts and ring-fenced as suggested in our answer to Q7.

97. While a spreading relief is welcome, there are also risks that taxpayers will need to consider, for example the risk that the rates of income tax and/or national insurance contribution rates will be increased during the transition period, resulting in the amount of tax due on the transitional profits increasing unexpectedly.

Question 10:

Are there any other impacts, benefits, or costs in the core policy, transition, or mitigation proposals that we have not considered above?

98. We set out below the potential impact of these proposals to medical professionals to illustrate the unintended consequences of making fundamental change to tax rules without first considering the wider ramifications. We should be clear that in the interests of fairness any solution would need to be universal.

99. Changes to basis period rules could have a knock-on effect to the NHS Pension, which follows the tax years (albeit to 31 March rather than 5 April). As a result, the superannuation certificate may need to be updated to reflect these changes. We note that the timing of these

measures is also likely to coincide with the implementation of changes arising out of the Government's response to the decision in the McCloud case in respect of judicial pensions.

100. Increases to the pensionable pay as a result of a change to the basis period could also have an impact on the annual allowance calculations (particularly for GP practices choosing to move to a March accounting date) and such increases generally result in large growth for these purposes. The doctors who are more likely to be affected are the "older" ones, who have been partners for many years where the additional tax burden and impact on their pension is more likely to result in them deciding to draw their pensions and leave the profession.

101. Significant numbers of GPs are still suffering annual allowance tax charges despite the increase in Finance Act 2020 to the tapering limit (due to not having unused allowances available from earlier years as a result of the historic tapering rules) and we understand that many GPs are moving in and out of the scheme to reduce their exposure to these charges. Succession planning is also a real problem area for GP partners, so retirements and the timing thereof is usually planned a long-time in advance. The short timescale proposed for these measures could adversely affect those who are planning (or have already planned) to retire in the next few years.

102. The use of estimates is also problematic with income streams being incredibly difficult to predict, even with the best forecasting systems in place. Partnerships can be large and GP partners regularly change work patterns which has an impact on profits for all partners in the practice. If the superannuation certificate is to follow the same treatment, estimates and amendments would also need to be submitted. The move to PCSE Online has pushed the processing of these certificates onto the practice managers, GPs and accountants, thereby leading to increased time pressures.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see https://goo.gl/x6UjJ5).