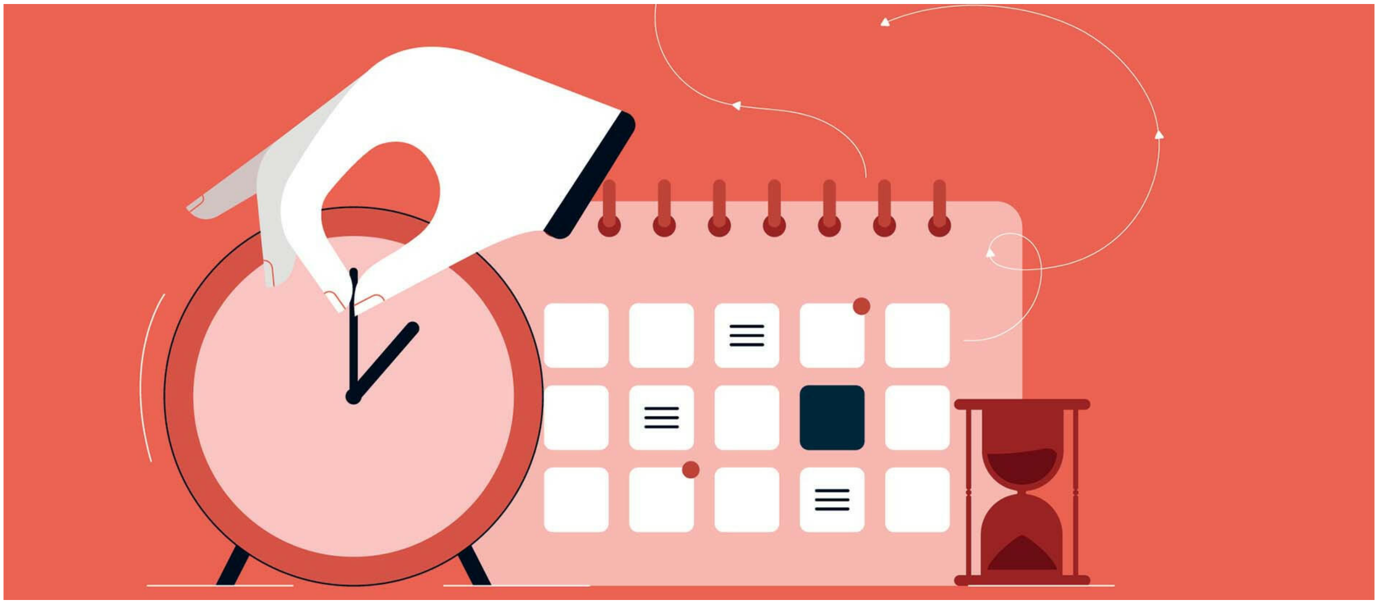
Basis period reform: moving to a 31 March year-end

Personal tax OMB



21 March 2023

Moving your accounting year-end to 31 March or 5 April could iron out some of the complexities of basis period reform. We ask if it's time for a change.

Key Points

What is the issue?

To avoid the complexity of basis period reform, some sole traders and partnerships may wish to change their accounting year-ends to 31 March.

What does it mean for me?

Advisers will need to consider whether a change of year-end is appropriate for affected clients and work out what the effects of this will be.

What can I take away?

Aligning accounting periods to the tax year or 31 March (which is effectively treated as the tax year-end for basis period purposes) will be appropriate for some clients, but there are practical and timing issues to keep in mind.

As set out in our article 'Basis period reform: transitional rules apply from 6 April 2023' in the March 2023 edition of *Tax Adviser*, the introduction of the tax year basis in 2024/25, and the transitional rules in 2023/24, are expected to create complexity and administrative burdens for sole traders and partnerships with accounting periods that do not run to 31 March or 5 April (about 7% of sole traders and 33% of partnerships).

In principle, this complexity goes away if the business moves its year-end to 31 March or 5 April. (31 March is effectively treated as equivalent to 5 April for overlap profit purposes per the Income Tax (Trading and Other Income) (ITTOIA) Act 2005 ss 7A-s7C, with 31 March often being the preferred date for the practical reasons summarised later in this article).

Once basis period reform comes into effect, there will no longer be a tax-related cash flow disadvantage in moving the year-end to 31 March. However, this does not necessarily work for all businesses, particularly complex ones. The timing of the year-end change can also have an effect on the overall tax position.

Timing issues

Change in 2022/23

There are important differences in tax treatment between moving to a 31 March year-end in 2023 compared to later years. If the date is changed in 2022/23, the normal change of accounting date rules under the current year basis will apply, resulting in the acceleration of profits and the relieving of overlap profits in 2022/23. This avoids the need to consider the transitional rules in 2023/24 but it also means that the five-year spreading provisions for transition profits will not be available.

If there would not otherwise be transition profits (e.g. because overlap profits are higher than the accelerated profit), it may be appropriate to change the date in

2022/23. The rules in ITTOIA 2005 ss 216-218, which limit the effectiveness of accounting dates for basis period purposes in some circumstances, should be borne in mind (these rules cease to have effect from 2023/24 onwards).

Change in 2023/24

In most cases where a change in year-end is appropriate, accounts will be drawn to 31 March 2024. In 2023/24, continuing traders will have a basis period running from the day after the 2022/23 basis period until 5 April 2024.

The first 12 months of this period is the 'standard part'. The 'transition part' is the remaining period to 31 March 2024, with the final five days not being taxed until 2024/25. If the profits in the transition part exceed the overlap relief, the net amount is then spread over the five tax years from 2023/24 to 2027/28. This may result in the taxable profits being broadly the same whether the year-end is changed or not, but it will depend on whether profits accrue evenly.

Oddities for partnerships

Under the current year basis, certain types of non-trading income of partnerships are taxed in accordance with the basis period for the trading profits (the 'notional business' rules). This typically affects untaxed interest and property income of partnerships. Whether a partnership's year-end is 30 April or 31 March, continuing partners would therefore normally be taxed based on the amount allocated to them for the accounting period ending in the tax year, without further adjustment.

Transitional rules apply in 2023/24, bringing income up to 5 April 2024 into charge in a similar way to trading profits, but without spreading provisions. From 2024/25, the notional business rules will no longer exist, leaving these sources of income to be taxed in the same way as personal sources. For firms with a 31 March year-end, this can create an odd situation where interest allocated to partners no longer necessarily matches the amount shown in the accounts. This is because interest is always taxed based on amounts arising between 6 April and 5 April.

Property businesses should be simpler as they can operate to a 31 March year-end from 2023/24 (ITTOIA 2005 ss 275A-275C).

Example: Impact of accounting date change

Helen has traded for many years, using an accounting date of 30 April. She has overlap profits of £30,000. Her results are:

- Year to 30 April 2023: **£100,000**
- 11 months to 31 March 2024: **£100,000**; or
- Year to 30 April 2024 (i.e. if no change of accounting date): **£120,000**

If Helen changes her accounting date to 31 March 2024, her transition profits will be £70,000 (£100,000 – £30,000). She will be taxed on £14,000 of this is in 2023/24, along with the £100,000 for the first 12 months (£114,000 total).

If Helen retains a 30 April year-end, her transition profits will be £80,000 (£120,000 x 11/12 – £30,000); in strictness, this would be calculated on a day’s basis.

She would then be taxed on £16,000 in 2023/24 along with the £100,000 for the first 12 months (£116,000 total).

Practical issues

For sole traders, changing the accounting date is fairly straightforward in principle. They do not need to file accounts, so they can normally choose the date that best suits them and then file their tax returns accordingly. For very simple businesses, particularly those on the cash basis, there might be no practical difference between a 31 March year-end and any other.

Not all businesses are this simple, however. For seasonal businesses, moving the year-end could create disruption to the business (e.g. it could push stock-takes and other accounting activities into the busiest time of year). Additionally, some taxpayers might already need to prepare accounts to a particular date for overseas tax reasons (e.g. a US resident entertainer with UK activities might need to prepare accounts to 31 December in any event).

Partnerships may be attracted to a 31 March year-end which, as noted above, is treated as co-terminous to the UK tax year to avoid the need to pro-rate accounting periods and profit allocations. There is the attraction of relative simplicity and clarity for individual partners as their personal tax returns can readily be reconciled to the partnership tax return and associated financial accounts. When Making Tax Digital (MTD) is extended to partnerships, a 31 March year-end will almost certainly make the transition to MTD easier.

A 31 March year-end date allows the longest period between the accounting period ending and the associated tax returns being due (10 months). This is time that a partnership may need, particularly those firms that prepared audited accounts and/or have complex profit-sharing arrangements which are not finalised for some months after the year-end date.

Despite the attractiveness of the 31 March year-end, there may be many partnerships which choose to retain their current year-end date. This may because there is limited choice; for example, US headed partnerships may be unable to change their year-end date.

Large and/or complex partnerships face a number of practical issues, such as:

- partner admission and retirement dates;
- adjustment of accounting systems and processes;
- the need to revisit audit timetables;
- changes to billing/cash collection cycles; and
- the need to consider year-end performance reviews, holiday period entitlement, and so on.

For partnerships with international offices, there may be non-UK tax considerations of changing their year-end date. Partnerships need to weigh up the possible benefits of a year-end date change with the effort expended on this change. There will be some partnerships where the benefits of a change to 31 March are limited; for example, those who will not be able to finalise their tax computations and double tax relief claims by the filing deadline regardless of their choice of year-end date.

VAT

Businesses registered for VAT may wish to change their VAT reporting periods to align with their new accounting year end (see bit.ly/3Jnfeek). This can be done online or by filing a VAT 484 form.

Concluding remarks

For those sole traders or partnerships that can change their year-end date to 31 March without significant disruption to their business (e.g. non-seasonal businesses), the simplicity and clarity of a year-end date co-terminous with the tax year may be attractive. For larger and more complex businesses, the benefits of a year-end change may be limited and need to be weighed against what can be significant practical challenges of a year-end date change.