

New tax year regime issues (Lectures B1353/1354 – 20.22/20.10 minutes)

Year ends which are not coterminous with the tax year

HMRC have indicated that some 7% of sole traders and 33% of partnerships do not use an accounting date which coincides with 5 April (or 31 March). If these businesses, which are assumed to be mainly seasonal operations or large partnerships, continue to draw up their accounts to their existing year end date, it will be necessary for them to apportion the profits of two periods of account to establish their taxable profits for a given tax year from 2024/25 onwards.

This will be particularly problematic for businesses with accounting dates falling fairly late in the tax year (e.g., 31 December). In order for, say, a sole trader with such a year-end to establish his profits for 2024/25, it will be necessary to calculate (using months):

- 9/12ths of his profits for the year ended 31 December 2024; plus
- 3/12ths of his profits for the year ended 31 December 2025.

Given that he has to settle his income tax liability for 2024/25 by 31 January 2026, the latter profit figure is unlikely to have been determined at that stage. The taxpayer will then be faced with the requirement to submit a self-assessment tax return containing estimated figures. These will have to be amended when the accounts for the year ended 31 December 2025 have been finalised.

In Para SALF206 of their Self-Assessment: The Legal Framework Manual, HMRC say:

‘There are occasions on which some information cannot be finalised within the formal self-assessment time limits despite the taxpayer’s best efforts to do so. In such cases, the taxpayer should include a “best estimate” of the information in the tax return and, if appropriate, a corresponding provisional figure of the tax due. The provisional figures should be clearly identified as such in the tax return. A tax return containing a provisional figure should only be submitted once it is clear that a more accurate figure will not be available before the filing date.

It helps HMRC to have a reason for the use of a provisional figure put on the tax return, together with an approximate time when the final figure is likely to be available. A tax return containing a provisional figure will not be regarded as unsatisfactory, but HMRC will consider whether to open an enquiry to look further at any provisional figure. A penalty for a careless or deliberate inaccuracy in a tax return could be charged if HMRC find there was no good reason for using a provisional figure or the amount was not estimated reasonably.

Once the correct figure is available, it should be notified to HMRC without delay, together with any amended self-assessment. If there is unreasonable delay in submitting the correct information, and there is additional tax to pay, HMRC would be able to charge a penalty on the basis that the original estimate was insufficient, even if the inaccuracy was neither careless nor deliberate when the original tax return was submitted.’

This means that, for all such taxpayers, they (or their advisers) will have to re-submit their self-assessment tax returns for each tax year once the final figures have been established. And this should be done without undue delay if a penalty is to be avoided.

In this regard, a recent article in 'Taxation' contained the following interesting piece of information:

'HMRC (are) currently considering how this process might be amended in future to accommodate the new basis period rules with a variety of options under review, including:

- amending the provisional return when the tax return for the following year is filed;
- extending the filing deadline for certain types of taxpayer more likely to be affected by this issue (e.g., seasonal trades and complex partnerships); and
- including the difference between the provisional amount and the final amount . . . in the return for the following year.'

As a result, it seems probable that many more businesses will conclude that a change of accounting date to, say, 31 March is the sensible path to follow.

Change of accounting date – but when?

It might be assumed that the logical time to effect this switch is during the transitional year which will involve producing accounts for the period ended 31 March 2024 – except that the accounts preparation will then have to be done simultaneously with the commencement of MTD when advisers and their clients are likely to be extremely busy.

The alternative is therefore to consider changing the accounting date during 2022/23 rather than 2023/24, but this gives rise to the unfortunate dilemma that profit spreading is only available for 2023/24 so that any additional profits brought into charge by changing the accounting date will be assessed in full in 2022/23 with no carry-forward facility.

Illustration 1

Trevor is an established sole trader who runs a seasonal business with a 30 November year end. He has, however, decided to change his accounting date to 31 March 2023 in an attempt to avoid the ongoing problems discussed above.

His profits for the year ended 30 November 2022 are £63,000. For the next four months, Trevor's profits total £29,000. His overlap relief carried forward is £4,800.

Given that Trevor has a 'relevant period' of more than 12 months (i.e., 1 December 2021 – 31 March 2023), his taxable profits for 2022/23 comprise:

	£
Year ended 30 November 2022	63,000
Four months ended 31 March 2023	<u>29,000</u>
	92,000
Less: Overlap relief	<u>-4,800</u>
	<u>87,200</u>

If, instead, Trevor had changed his accounting date in 2023/24 (but using the same set of figures), his assessable profits for 2023/24 would be calculated as follows:

	£
Year ended 30 November 2023 (CYB)	63,000
Transition (1 December 2023 – 31 March 2024)	<u>29,000</u>
	92,000
Less: Overlap relief	<u>-4,800</u>
	<u>87,200</u>

These profits exceed the profits determined under the current year basis by £24,200 (£87,200 – £63,000) and so Trevor can spread the excess over five years. The amount to be added to his 2023/24 assessment is £4,840 ($24,200 \div 5$).

Trevor's profits for 2023/24 are therefore £63,000 + £4,840 = £67,840. This is clearly preferable to being taxed on £87,200.

However, if, as may well be the case because of the continuing effects of COVID-19, a business has recently been running less profitably, an early change of accounting date can sometimes prove to be advantageous.

Illustration 2

Hector's profits for the year ended 31 July 2022 are £42,000. However, for the next eight months, his profits only total £10,000. His overlap relief carried forward is £22,000.

Given that Hector also has a 'relevant period' of more than 12 months (i.e., 1 August 2021 – 31 March 2023), his taxable profits for 2022/23 comprise:

	£
Year ended 31 July 2022	42,000
Eight months ended 31 March 2023	<u>10,000</u>
	52,000
Less: Overlap relief	<u>22,000</u>
	<u>30,000</u>

Without the change of accounting date in 2022/23, Hector's taxable profits would have been £42,000. The change in 2022/23 gives Hector a better result.

One set of accounts or two?

Where an accounting date is changed in 2023/24 to 31 March, does it matter whether the trader uses one set of accounts or two to cover the change period? Do not overlook the fact that, because Para 65 Sch 1 FA 2022 applies to basis periods for 2023/24, the 18-month restriction in S217 ITTOIA 2005 is irrelevant. As one commentator has said:

'This means that the taxpayer can prepare a single set of accounts and self-employment pages for any period up to 23 months (which would apply where the old accounting date is 30 April).'

Illustration 3

Matthew, an established sole trader, has always prepared accounts to 31 August each year.

Matthew's profits for the year ended 31 August 2023 are £72,000. He plans to change his accounting date to 31 March 2024 and his trading results for the seven months ended 31 March 2024 show a profit of £61,000. He has no overlap relief carried forward, given that he made a loss for his first two years of trading.

If Matthew prepares a single set of accounts covering the 19 months to 31 March 2024, his assessable profits will comprise:

	£
Standard part ($12/19 \times £133,000$)	84,000
Transition part ($7/19 \times £133,000$)	<u>49,000</u>
	<u>133,000</u>

These profits exceed the profits determined under the standard part by £49,000 ($133,000 - 84,000$) and so Matthew can spread the excess over five years. The amount to be added to his 2023/24 assessment is £9,800 ($49,000 \div 5$).

Matthew's taxable profits for 2023/24 are therefore $£84,000 + £9,800 = £93,800$. However, if Matthew prepares two separate sets of accounts for this period, the following calculation will apply:

	£
Standard part (year ended 31 August 2023)	72,000
Transition part (7 months to 31 March 2024)	<u>61,000</u>
	<u>133,000</u>

These profits exceed the profits determined under the standard part by £61,000 ($£133,000 - £72,000$) and so Matthew can spread the excess over five years. In this case, the amount to be added to his 2023/24 assessment is £12,200 ($61,000 \div 5$).

Matthew's taxable profits for 2023/24 are therefore $£72,000 + £12,200 = £84,200$. This permutation produces a better outcome for 2023/24. Matthew should prepare two sets of accounts. It has been brought about by the fact that the profits have accrued at an uneven rate over the 19-month period to 31 March 2024.

As can be seen in Illustration 4 below, there will be a different end result if the business profits are declining.

Illustration 4

Yasmin has always prepared accounts to 31 October each year, but she is planning to change her accounting date to 31 March in 2024.

Yasmin's profits for the year ended 31 October 2023 are £94,000. Her trading results for the five months ended 31 March 2024 show a profit of only £4,600. Her overlap relief carried forward is £3,000.

If Yasmin prepares a single set of accounts covering the 17 months to 31 March 2024, her assessable profits will comprise:

	£
Standard part (12/17 x £98,600)	69,600
Transition part (5/17 x £98,600)	<u>29,000</u>
	98,600
Less: Overlap relief	<u>3,000</u>
	<u>95,600</u>

These profits exceed the profits determined under the standard part by £26,000 (£95,600 – £69,600) and so Yasmin can spread the excess over five years. The amount to be added to her 2023/24 assessment is £5,200 (26,000 ÷ 5).

Yasmin's taxable profits for 2023/24 are therefore £69,600 + £5,200 = £74,800.

However, if Yasmin prepares two separate sets of accounts for this period, the following calculation will apply:

	£
Standard part (year to 31 October 2023)	94,000
Transition part (5 months to 31 March 2024)	<u>4,600</u>
	98,600
Less: Overlap relief	<u>3,000</u>
	<u>95,600</u>

These profits exceed the profits determined under the standard part by £1,600 (£95,600 – £94,000) and so Yasmin can spread the excess over five years. In this case, the amount to be added to her 2023/24 assessment is £320 (1,600 ÷ 5).

Yasmin's taxable profits for 2023/24 are therefore £94,000 + £320 = £94,320. This permutation produces a significantly less attractive outcome for 2023/24. Yasmin should prepare a single set of accounts.

Establishing a taxpayer's overlap relief

The position with regard to establishing the quantum of overlap relief was neatly summarised by one commentator in these words:

'Overlap profits arise in the first two years of a business for businesses which commenced on or after 6 April 1994. The precise overlap period will depend on the commencement date and the chosen accounting date and will also depend on whether the business has previously changed its accounting date, as, in that event, some overlap profits may have been released (or additional overlap profits created) at that time.'

For businesses which started in the pre-current year basis era, the overlap profits were called 'transitional overlap relief', given that they arose during the transition from the preceding year basis regime to the current year basis regime. This form of overlap relief may therefore go back many years.

A significant number of businesses do not have a record of their overlap relief history, particularly many older ones, and so they will be looking to HMRC for the information which will enable the relief to be calculated. However, will HMRC be in a position to provide the relevant details?

A senior HMRC official recently informed the House of Lords Economic Affairs Committee that HMRC were working on a process to provide taxpayers with the information which they hold on to their overlap relief. He also implied that, even where the relevant figures are not immediately available, it may still be possible to calculate the relief from the records which they hold. However, it seems clear that, where the business started up many years ago, it is most unlikely that tax returns and other relevant records will be found by taxpayers, their advisers (who may well have changed over the years) or HMRC. In that case, it appears that taxpayers will unfortunately be unable to claim their relief. One cannot envisage HMRC granting relief where there is no evidence to support the claim.

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