Briefing Note

Mercer & Hole

BASIS PERIOD REFORM

Is it time to change your accounting date?

Finance Act 2022 introduced provisions to change the timing of when the profits of unincorporated businesses (including trading partnerships and LLPs) are taxed. These changes are imminent and will impact from the 2023/24 tax year. They could have wide-reaching cash flow implications and potentially, significant administrative costs for all unincorporated businesses (except those that already prepare their accounts to 31 March or 5 April).

The current position (soon to become the 'old rules')

Under current rules, unincorporated businesses are taxed on the profits of their 12-month accounting period ending in the tax year, with special rules applying in the opening and closing years (or where there is a change to the accounting date).

For example, if a business draws up its accounts to 30 September, in the 2022/23 tax year, it will be taxed on the profits for the year ended 30 September 2022.

The 'opening year' rules are complicated and often result in profits being taxed twice in the early years of a business (or when a new partner joins a business), creating what is known as *overlap profits*. These can then only be utilised on a change of accounting date or on cessation (including retirement from a partnership). This can have a significant impact on cashflow, albeit that the current rules can also lead to a significant deferral of tax if an appropriate accounting date is chosen. This has always been particularly useful for a business with rising profits.

2023/24 – The transitional year

The 2023/24 tax year will be a transitional year in which business will move from the old basis to the new basis and be assessed on the following profits:

- The profits of the accounting period ending in the tax year
- The profits from the period starting immediately after the end of that accounting period to 5 April 2024, less any available overlap relief brought forward

Using again the example of a 30 September year end, this would result in the profits of the year ending 30 September 2023 and the period 1 October 2023 to 5 April 2024 (i.e., 18 months' profit) all being taxable in 2023/24, albeit reduced by any available overlap.

If the profits assessable in 2023/24 are higher than they would have been under the old rules (which they will be if the business is more profitable now than it was when the overlap profits arose), the additional amount can be spread over five tax years (including 2023/24).

Taxpayers will have the ability to bring additional amounts into charge in any of the first four years if they so wish (perhaps because they have concerns over future tax rates) and if the business ceases during the five-year period, any additional profits that have not been taxed will come into charge in the year of cessation.

2024/25 onwards – The 'new rules'

From the 2024/25 tax year, all unincorporated businesses will be subject to tax on the profits arising in the tax year, irrespective of what date their accounts are drawn up to.
Consequently, those businesses with year ends other than 31 March or 5 April will have to apportion their profits on a pro-rata basis to determine the taxable profit for the tax year, which I suspect will lead to many businesses choosing to adopt a 31 March year end in the future. On the plus side, the concept of overlap relief and all the disadvantages and complexities that come with it will disappear!

What should I be doing now?

Many businesses will already be part way through their transitional accounting period and should be considering the following:

- How these changes will impact on their cashflow and whether this will require additional funding, particularly in relation to the tax payable in January 2025 (which is when any potentially significant 'catch up' payment is likely to be).
- The merits of adopting an accounting date of 31 March or 5 April going forward to align with the tax year and, most importantly, the appropriate timing of such a change. Accurate profit forecasts will be crucial when it comes to decisions on the timing of any accounting period changes.
- The timing of accounting and tax computation work – does this need to be brought forward to avoid estimates which would then only have to be amended at a later date (thus adding to the cost)?

As always, if you have any questions on how these changes might impact on your usual Mercer & Hole contact.