IFA REPRESENTATION 08/21

The IFA welcomes the opportunity to provide feedback to the consultation on basis period reform published by HMRC on 20 July 2021.

We would be happy to discuss any aspect of our comments and to take part in all further consultations in this area.

Institute of Financial Accountants
Member of the IPA Group
CS111, Clerkenwell Workshops
27-31 Clerkenwell Close
Farringdon, London EC1R 0AT
T: +44 (0)20 3567 5999
E: mail@ifa.org.uk
www.ifa.org.uk

Established in 1916, the Institute of Financial Accountants (IFA) is an internationally recognised professional accountancy membership body. Our members work within micro and small to medium sized enterprises or in micro and small to medium sized accounting practices advising micro and SME clients. We are part of the Institute of Public Accountants (IPA) of Australia Group, the world's largest SME-focused accountancy group, with over 40,000 members and students in over 80 countries.

The IFA is a full member of the International Federation of Accountants (IFAC) the global accounting standard-setter and regulator. We are also recognised by HM Treasury and the Financial Services Authority in the Isle of Man to regulate our members for the purposes of compliance with the Money Laundering Regulations.

For more information, please contact the IFA mail@ifa.org.uk

www.ifa.org.uk

1. Purpose

The views contained in this report are those of the IFA as a body and do not represent the views of any one person. Feedback was taken from a number of IFA members and supporters to form the basis of this report.

2. Approach

The IFA consulted its members concerning the consultation: Basis period reform. This response reflects the views of 41 IFA members who took part in an IFA members' survey.

We have referenced the responses below using the original question numbers from the consultation paper.

3. Executive summary

The IFA supports the modernisation and digitalisation of the tax system. However, we are very concerned about how a change in basis period will fit into the overall timetable announced in July 2020 for MTD which includes extending VAT to all VAT-registered businesses from April 2022 and quarterly income tax reporting from April 2023 for MTD ITSA. Corporation tax MTD is still be consulted.

While IFA members are largely in favour of the change to the tax year basis, as most unincorporated businesses use a 31 March or 5 April accounting period end already, there are a number of significant concerns summarised below and in the detailed responses to the specific questions.

The roadmap for MTD detailed above will mean that many more individuals and businesses will be within the scope of MTD than before. These individuals and businesses will require help and support with the transition. Some of these individuals and businesses may not have a tax agent. There is no detailed timetable of MTD ITSA and how the propose changes in the basis period will be implemented. We strongly urge HMRC to consult on this further before proceeding further.

Specifically on the changes on the basis period reforms, while this is largely supported by IFA members, we are concerned that seasonal businesses will find it difficult to prepare accounts during their busy season. These businesses have often deliberately chosen an accounting period end that allows them to bring together their accounts when their businesses are less busy.

Apportionment of profits to different tax years is something most IFA members would want to avoid, as it creates an additional cost for the business with no benefit. Businesses with a non-tax year accounting period would be encouraged to change their year-end to 31 March. Some businesses would want to make this change in the current year (2021/22) rather than wait until 2022/23. Guidance from HMRC would be required on how to do this.

Many IFA members are concerned about the concentration of work for accountants who will need to assist all of their clients to report income and expenses to the same quarters under MTD ITSA.

4. Detailed response

Q1. 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?

Many IFA members believe that the change to a tax year basis will effectively push businesses into using an accounting period ending on a date between 31 March and 5 April.

Some 44% of IFA members, who responded to the survey, are in favour of the tax year end or 31 March to be mandated as the accounting period end for all unincorporated businesses, but 56% are not in favour of such a mandated year end.

There are real concerns about the proposed change to the tax year basis, as illustrated by the following comments:

- It will cause hardship for businesses who have been operating with a different basis period for many years, plus additional costs in accountancy fees.
- There will be confusion which the accountancy profession will bear the brunt of at a time when we will still likely be recovering from the effects of a world pandemic.
- The changeover is beyond the understanding of micro clients like taxi drivers, and some seem to be left with comparatively huge liabilities in the changeover year.
- The 5th April date is anachronistic and meaningless. The tax year should end on 31 March and any accounting year end dates should run to the end of a month.
- Any reform should first address the underlying absurdity of a 5 April tax year end. Sooner or later the tax year will have to be changed. If the introduction of a mandatory accounting year was implemented simultaneously with that change I would support it, but doing it as proposed means we are going to have two periods of upheaval instead of one.
- It would create huge amounts of work for accountants during one part of the year. If there had to be a mandatory year end for all businesses, 31st December would make more sense. Many companies have overseas parents/subsidiaries which need to have concurrent year ends, and the rest of the world is 31st December.
- MTD can be done without this change. Businesses should just do quarterly reports for tax and VAT by reference to their existing year end.

Q2. 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?

A large majority of IFA members (68%) would recommend that their clients who currently do not use a 31 March / 5 April year end, should change to use that accounting date. Only 17% of IFA members would advise such clients to retain their non-tax year accounting period and apportion profits to tax years as required.

Comments in favour of changing to the tax year basis include:

- Makes the transition to MTD easier if done now
- I already ask new clients to change to 31st March when I take them on
- It makes it simpler to align accounts and tax liabilities

- After the first year it would provide uniformity and given that all self-employed work to the same January deadline it would work OK after year 1. It would also be easier for clients to understand.
- Do this now while the taxable profits for this year should be lower than previous year.

Around 15% of members would advise clients to review the structure of their business and possibly incorporate the business.

Q3. 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?

Over 90% of IFA members agree that there would be an additional cost to clients where an apportionment of profits between tax years is required. The average cost per client would be £200 to £500 per year, but nearly a quarter of members estimate the extra costs would be £500 to £1,000 per year.

IFA members are concerned about the pressure on accountants to produce accounts for all of their unincorporated clients at the same time. Comments include:

- The pressure on accountants over a particularly small window in the year from clients all requiring their accounts prepared at the same time would be very difficult to manage.
- The accountancy profession will never be able to manage the workload and much shorter time spans between end of year and tax return deadlines. At present these are reasonably spread out.
- I cannot explain to non-accountants why I must charge more for doing accounts and then doing apportionments
- This will put accountants and businesses under enormous pressure when we're just recovering from the additional work brought by Covid. I don't think I'll be able to cope with it.

Q4a. 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?

The businesses particularly affected by the need to estimate profits will be those with account periods ending from 30 September to 28 February. Those with November or December year ends will be the hardest hit.

The type of businesses which will need to estimate profits to be assessed on a tax year basis will include:

- Seasonal traders
- Farmers
- Construction industry businesses

- Dentists
- Medical practitioners
- Educational sector
- Tourism

Q4b. 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?

IFA members felt the change would hit sole-trader businesses the hardest as they have few resources to pay for extra accountancy help.

The estimates of the cost burden for these businesses vary from £100 to £1500, as it will depend of the complexity of the business and how different their financial year end is from the tax year end.

IFA members suggested the following alternative strategies to solve this problem:

- Do not bring in MTD as it only benefits HMRC
- Continue with the current once-a-year filing until the new systems are debugged
- Change accounting period now before the next filing date.
- Adopt 31 December as the tax year end to align with most other countries

Q5. 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?

The 31 March year end is already treated as equivalent to 5 April by concession for property letting businesses, so putting this on a statutory footing makes little practical difference.

Q6. Are there any specific issues, costs, or benefits to the tax year basis for partners in trading partnerships?

These are some of the comments from IFA members regarding issues relating to partnerships having to change to a tax year basis:

Costs

- Upheaval in administration for changing the Year End, extra costs and no benefit to the business.
- Additional accountancy costs that they otherwise would not incur.

Benefits

- The change to tax year basis should reduce the delay in completion of accounts and tax returns to be filed on time.
- Some partners will be the able to offset overlap profits ahead of time.

- There will be a shorter time gap between the date tax is payable and the earning period for the profits assessed. All income of the partners will be assessed on the same basis period so it will be easier to understand.
- There will be a one-off cost but tax returns will be a lot easier in future years when there are changes in the partnership.

Other issues

- Individual partners may be involved in several different businesses and the calculation of profits in the transitional basis will be very complex and costly to compute. Detailed HMRC guidance will be needed in advance of how multiple trades and professions will be dealt with for a single taxpayer. The guidance should include the situation where some of those sources of income may be overseas partnerships.
- There will be a large extra tax liability and so a potential debt burden for up to 5 years, this will be difficult to manage for partners that leave or join the firm in that period.
- Changes in partnership profit sharing agreements may be required, and that may result in disagreements between partners and/or legal costs.
- It could be a nightmare for partnerships of solicitors.
- Possible problems with the interaction of CA/AIA on the firm's profits and profit-shares.

Q7. 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?

All of the IFA members who responded to the survey predict that there will be one-off costs for clients to report profits and losses in the transitional year (2022/23) and to calculate the spreading of profits into later years. The majority (70%) believe these costs would range between £100 to £500 per client.

Businesses who have not traded to a tax year or 31 March year end may have significant amounts of overlap relief to set-off in the transitional year (2022/23). Although around 40% of IFA members are confident that they have accurate records of the overlap relief that their clients will be able to claim, over 46% will ask HMRC for the overlap relief figures. This could pose a significant burden on HMRC's phonelines, unless some automated function is put in place to request and provide the overlap figures.

Q8a. 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?

The IFA is concerned that this major change in assessment of profits and losses for unincorporated businesses is being rushed through to facilitate the start of MTD ITSA in 2023. Over 24% of IFA members would like to see mandation of MTD ITSA deferred for one year, and the transition to the tax year basis to occur in 2023/24.

Nearly 44% of the IFA members would rather there was no change in basis periods at all.

Q8b. Are there any other specific circumstances on transition to the tax year basis that would require additional rules?

There are many charges and deductions affected by the taxpayer's total taxable income assessed in the tax year, and rules for all of the following would need to be adjusted to take into account the artificially high income assessed in the transition year (2022/23).

IFA members have suggested the following solutions in each case:

High income child benefit charge
- Raise income threshold of £50,000. This is threshold is now within the basic rate band, which defeats the objective to only apply the HICBC to higher earners.
- Disregard all the additional profits assessed because of the transition
- Abolish the HICBC

National Insurance Contributions
- Calculate NI on basis of 12 month's proportion of profit
- Disregard all the additional profits assessed because of the transition
- If the excess profits are spread forward over 5-years so should the NIC payable in-line with those carried forward profits.
- Take average profit of previous two years

Student loan repayments
- The loan repayment should be capped based on 12 month period proportion
- Cap loan repayment based on average of two preceding years
- increased profits due to transitional year should be ignored

Working Tax Credits
- Use the current year basis of profits for the transitional year
- Increased profits should be ignored
- Tax credits should be renewed based on previous year
- Base on a 12 month pro-rata period

Averaging of farming or creative profits
- set maximum based on 12 month proportion of profits
- Average actual transitional year profits with preceding tax year regardless of basis of former
- Increased profits due to the transition should be ignored

Q9a. 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?

Most of our members (51%) agree that the spreading of excess profits from the transitional year forward over five years is the best solution.

However, two other solutions were suggested:
1. Index overlap relief by inflation from the date it arose to 2022/23 and deduct that indexed value from profits assessed in 2022/23. Do not spread forward any profits.

2. In the transition year assess 12 months profit based on the current year basis, but do not assess any profits or deduct expenses from the end of the last accounting period to the start of the next tax year. Do not deduct overlap relief.

Q9b. 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?

Just over 39% of IFA members agree that spreading the excess transitional profits over five years will be enough to mitigate the cash-flow disadvantage for taxpayers of having profits bunching into 2002/23. However, 17% think the spreading period should be six years or more.

Two other solutions to the excess profits problem are suggested:
1. Don't spread profits forward, but instead give taxpayers a tax credit equal to the excess tax paid in 2022/23, to carry back and set against earlier years tax.
2. Do not spread forward profits, but instead allow taxpayers to defer part of the excess tax due for up to five years.

Q10. Are there any other impacts, benefits, or costs in the core policy, transition, or mitigation proposals that we have not considered above?

Some IFA members felt the change to the tax year basis should be optional and not mandatory.

Guidance will be needed on the rules around changing an accounting period to 31 March, especially if it involves a long period of account of 18 months or more.

Some IFA members would want their clients to change the accounting period advance of 2022/23, to lengthen say a period ending on 31 August 2021 to a 19 month period ending 31 March 2022. The earlier change would absorb losses/low trading in the pandemic period from March 2020 to July 2021 into the long accounting period.

Q11. Are any other specific impacts on other groups or businesses that we have not considered above.

IFA members are concerned that the change to the tax year basis will force unincorporated businesses to adopt a 31 March or 5 April year end, when this will not suit the seasonable nature of their business. For example:
- Accounting dates are chosen for various reasons, especially to have them fall into the quiet time of year eg a hotel is better able to deal with admin in winter than in spring; a toy shop is better able to deal with matters in January than in December.
- It would seemingly destroy the ability to take account of differing circumstances.
- Businesses are busy at different times and the consequent quarter dates might be inconvenient. Whatever happened to freedom of choice?
- Some accounting periods are chosen to accommodate seasonal trends in trading

- It will take away the flexibility required to allow businesses to change their accounting periods to take account of different factors such as smoothing out trading variations.