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DRAFT FINANCE BILL 2021-22 CALL FOR EVIDENCE: INCOME TAX BASIS PERIOD REFORM

Response by Association of Taxation Technicians

1 Introduction

1.1 The Association of Taxation Technicians (ATT) is pleased to have the opportunity to respond to the call for evidence[1] by the House of Lords Economic Affairs Committee's Finance Bill Sub-Committee ('the Sub-Committee') in relation to proposals for income tax basis period reform.

1.2 The primary charitable objective of the ATT is to promote education and the study of tax administration and practice. We place a strong emphasis on the practicalities of the tax system. Our work in this area draws heavily on the experience of our members who assist thousands of businesses and individuals to comply with their taxation obligations. This response is written with that background.

1.3 We note that the Sub-Committee's call for evidence relates to both income tax basis period reform and the notification by large businesses of uncertain tax treatment. However, we have restricted our comments in this response to basis period reform alone, as the area which is of most direct relevance to the businesses which our members assist. This response complements and accompanies the oral evidence provided to the Sub-Committee by ATT Technical Officer Emma Rawson on 11 October 2021.

1.4 Overall we believe that, whilst the proposed reforms present an opportunity for simplification, this needs to be balanced against the increased complexity, administrative burdens and costs which will arise for those businesses which do not have a 31 March or 5 April year-end.

1.5 We had previously been deeply concerned about the proposed timetable for basis period reform, and therefore welcome the announcement on 23 September 2021[2] that these changes will not come into effect before April 2024, with a transition year not coming into effect earlier than 2023. If reform is to go ahead, we would encourage HMRC to use this time to engage with stakeholders with a view to minimising the additional burdens placed on affected businesses as much as possible.

1.6 We have set out our response to the specific questions posed by the call for evidence in relation to basis period reform in Section 2 below.

[1] https://committees.parliament.uk/call-for-evidence/585/
[2] Written statements - Written questions, answers and statements - UK Parliament

1.7 We would be pleased to discuss any aspect of this response further. Relevant contact details can be found in Section 3.

2 Call for evidence questions: income tax basis period reform

Question 1: How far does the reform represent a useful simplification?

2.1 Overall, whilst the proposed reforms present an opportunity for future simplification, there is the potential for them to cause a marked increase in complexity for affected taxpayers.

2.2 As noted at 2.29 below, the current basis period rules have been in place since the introduction of self-assessment in the 1990s, and are therefore familiar to many. However, they can be complex to apply in practice, especially for unrepresented taxpayers who don't opt for a 31 March/5 April year end. The change to a tax year basis would remove much of this complexity, in particular there would no longer be a need for the special rules which apply to determine taxable profits in the early years of a business, on business cessation and when there is a change in accounting period date.

2.3 However, the proposed changes will deliver extra complexity for those businesses with a year-end other than 31 March or 5 April. In particular, as set out at 2.18 – 2.20 below, some of these businesses will (every year) be required to estimate their profits for a period, and finalise these estimates at a later date.

2.4 As set out in our response[3] to HMRC's recent consultation on basis period reform, other areas of potential complexity include the interaction with existing tax relief rules, for example the averaging rules for farmers and creative artists.

2.5 If basis period reform were to go ahead, we would strongly encourage HMRC to explore how the additional complexities posed by the requirements can be minimised.

Question 2: To what extent would the reform deliver a fairer result than the current rules?

2.6 The proposed reform will not affect the majority of existing unincorporated businesses (those that already have a 31 March or 5 April year-end), but those who are affected will face potentially significant additional administrative burdens and tax bills. In particular, there will be an acceleration of the extra tax those businesses would have otherwise paid on ceasing to trade or changing accounting period, as well as one-off and ongoing administrative burdens.

2.7 The main beneficiaries of basis period reform are likely to be those businesses which commence after it is introduced. They will have easier rules to apply when determining their profits in the early years of trade, and will not incur overlap (which under the current rules can result in the same profits being taxed twice). Whilst such overlap can be relieved on the future cessation of the business, or a change in accounting date, HMRC's consultation indicates that not all businesses claim this relief in practice, and it therefore represents a real cost to some businesses.

2.8 Another perceived 'unfairness' of the current rules which would be addressed by the proposed reform is the impact that accounting date can have on how long a business has to pay their income tax. For example, under the current rules, a business with a 30 April accounting period has 23 months from their accounting

[3] https://www.att.org.uk/technical/submissions/basis-period-reform

period end until their final balancing payment of income tax is due for that period. By contrast, those with a 31 March year end have only ten months.

Question 3: Would either of the alternative options mentioned in the consultation document be a better solution? If so, why?

2.9 The two alternative options are:

- Mandating a 31 March or 5 April accounting date
- A corporation tax type approach with payment and return dates linked to the accounting period of the business.

We do not believe either of these would provide a better solution.

2.10 Whilst the first of these would apparently deliver simplification, the approach is too inflexible and does not take into account the commercial reasons why some businesses may choose to have a different year end. For example, farmers commonly have a year-end other than 31 March or 5 April depending on their harvest / livestock sales times. We also understand that the accounting date of some large professional partnerships is dictated by the overseas networks of which they form part. Imposing a specific accounting date on these businesses would lead to significant practical difficulties for them.

2.11 By contrast, whilst a corporation tax type approach would be very flexible, allowing businesses to choose their accounting period with filing and payment dates moving accordingly, this would not represent a simplification. Such a change would require significant adjustments to HMRC's systems, as well as those of taxpayers and agents. The differing deadlines could also lead to confusion amongst taxpayers (especially unrepresented taxpayers). Moving payment deadlines would also, presumably, have a cash flow impact for the Exchequer.

Question 4: Are the transitional provisions sufficiently robust? If not, how do they need to change?

2.12 Overall we believe that the proposed transitional provisions are sensible and robust. We do however have a number of practical concerns, as set out below.

2.13 One area of concern is the impact on taxpayers who do not have a record of their original overlap. This may be particularly common amongst older businesses, as well as those who have changed agent since commencement. To address this, we believe that HMRC should put in place a system to provide overlap relief figures to affected taxpayers. This would be of significant benefit not just to those taxpayers who could otherwise miss out on relief due, but also to HMRC in terms of allowing verification of amounts included in returns and ensuring that excessive overlap relief is not claimed.

2.14 Another area of concern is whether the ability to spread excess profits will be available to those who change accounting date in anticipation of this reform. We would recommend that those who change their accounting date to 31 March or 5 April in advance of, or during, the transitional year, be allowed to spread any excess profits which could arise. Changing in this way will simplify matters for the business in question (in removing the need to estimate / apportion profits) and it would seem counter-intuitive to remove the incentive to do so.

2.15 Finally, we note that, whilst a five year spreading period is likely to be sufficient for the majority of businesses, there may be cases where a longer period of spreading would be helpful due to the additional amount of tax arising. This could be the case, for example, where the current accounting date causes a large amount of extra profits to be taxed in the transitional period or there is a lack of overlap profits due to losses or low profits in the early years of trade. In such cases, consideration should be given to allowing those affected to apply for a longer spreading period of up to ten years, subject to HMRC approval.

Question 5: How onerous is apportionment of profits between tax years likely to be for businesses which do not have an accounting period aligned with the financial/tax year?

2.16 We assume that the approach to apportionment would be to calculate the taxable profit or loss on an accounting period by accounting period basis (as is currently the case), before then splitting this between the relevant tax years on a time basis.

2.17 On this basis, we would not anticipate apportionment to be overly problematic in practice once the relevant sets of accounts have been prepared. Rather, we would expect it to be an exercise which software is able to handle (in a similar way to how corporation tax software currently apportions profits of an accounting period betweenfinancial years). Instead, we believe the greater administrative burdens will arise where there is a requirement to estimate profits and finalise those estimates.

2.18 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. HMRC's consultation suggests this will be necessary for accounting dates from 30 September onwards, but our members indicate this could be as early as 31 July.

2.19 Estimation of profits will represent a significant burden for affected businesses. The exact level of this burden will depend upon how estimation is expected to be carried out. In particular, the level of accuracy expected of estimates, and the amount of information that the business needs to report to support that estimate, will affect how challenging this is. The size of the business will also increase the complexity of estimations. We would support a flexible approach, allowing businesses to make estimates in the way they best see fit, provided the approach taken is robust and consistent.

2.20 Where estimates are made, these will subsequently need to be finalised in some way. HMRC's consultation proposes that this could be done by filing an amended return, something which will result in extra administrative burdens and adviser's fees for those affected. Consideration should be given to introducing a stand-alone, simpler system for finalising estimates.

Question 6: How manageable is the timetable, especially vis-à-vis the introduction of Making Tax Digital for income tax?

2.21 In our response to HMRC's consultation on basis period reform, we expressed strong concern over the previously proposed timetable for that reform and Making Tax Digital for Income Tax Self-Assessment (MTD). We therefore welcome the announcement on 23 September 2021 of a one year delay to both reforms.

2.22 This delay should provide more time to consult on basis period reform, and identify and address potential issues. However, we remain concerned that introducing a transitional year in 2023/24, followed by MTD from April 2024, represents too much change in too short a period of time.

2.23 Under this timetable, there will be two large reforms to income tax calculation and reporting in the space of two years. This will place a significant burden on taxpayers and agents, as well as HMRC who will have not to only implement these reforms but also guide and support taxpayers through them. In addition, those who may have made mistakes in implementing the complex transitional rules will not have time to correct these before coming within the requirements of MTD.

2.24 Ideally, we would therefore like to see more time given to allowing basis period reform to bed in before moving on to MTD.

Question 7: What is Her Majesty's Revenue and Customs doing to support businesses in making the change?

2.25 We are unable to comment directly on the work HMRC are doing to support businesses.

2.26 However, if these reforms do go ahead, we note that they will require an extensive public education campaign from HMRC to raise awareness, especially amongst those unrepresented taxpayers. HMRC will also have to ensure they have adequate resources to assist those taxpayers and agents who need support during the transitional period, to ensure that they apply the rules correctly, and that taxpayers claim the overlap relief to which they are entitled. It will be essential for HMRC to be adequately resourced.

Question 8: How important is reform of the basis period rules in the context of the Government's 10-year strategy for the tax administration framework?

2.27 The tax administration framework strategy is extensive in scope, with basis period reform forming only a relatively small component.

2.28 However, we note that that, if reform were to go ahead, it would align MTD quarterly updates with the year-end reporting of a business. Under the recently published MTD regulations[4], quarterly update periods will align with the tax year (and not the accounting period of a business). However, the end of period statement (EOPS) used to determine the taxable profits of the business will, in the same way as the current income tax return, be linked to the accounting period of the business. As a result, in the absence of basis period reform, where businesses have a year-end that does not align with one of the tax year quarters, it will be very difficult (or impossible) to align information included in MTD quarterly updates with that reported on the EOPS ..

Question 9: How much of a problem are the existing basis period rules in practice?

2.29 The current basis period rules have been in place for since the introduction of self-assessment in the 1990s, and are therefore familiar to many. Our members report that, whilst the rules can be difficult to apply in the opening and closing years of a business, once the business is established they are fairly straightforward and logical to apply in practice. They also permit flexibility in the choice of year end which can be commercially helpful. Whilst this flexibility may be maintained following basis period reform, those who do not choose to change to a 31 March or 5 April year-end will have additional administrative burdens, as set out above.

2.30 However, we appreciate that applying the current rules may be more complex for the unrepresented taxpayer. This may be a contributory factor behind the concern noted in HMRC's consultation that more than half of those affected by the rules do not claim the overlap relief they are entitled to.

Question 10: How does the proposal fit with the work the Office of Tax Simplification is doing on the date of the end of the tax year?

2.31 We note that the Office of Tax Simplification (OTS) report on changing the tax year end published on 15 September 2021[5] does not recommend that a change be made in the immediate future. If such a change were to be made after the introduction of basis period reform, then the impact would depend upon the date chosen.

[4] https://www.legislation.gov.uk/uksi/2021/1076/made
[5] https://www.gov.uk/government/publications/exploring-a-change-to-the-uk-tax-year-end-date

2.32 If the tax year end were to be changed to 31 March, there would be minimal impact of these proposals, as they already include a proposed equivalence of 31 March to 5 April.

2.33 However, if a more radical change to 31 December were favoured, this would be a marked shift, and we would not want to see another re-alignment of the basis period rules required in a few years' time as a result.

2.34 Even if no formal change were to be made to the tax year end or the basis period rules reformed, we would support the recommendation of the OTS that, in the short term, government and HMRC should focus on allowing the self-employed and individual landlords to use 31 March in place of 5 April when reporting their income (what is referred to as 'equivalence' in both the basis period consultation and the OTS report). This would provide a helpful practical simplification, as well as assist with the eventual introduction of MTD.

3 Contact details

3.1 Should you wish to discuss any aspect of this response, please contact our relevant Technical Officer, Emma Rawson on 07773 087111 or erawson@att.org.uk .

The Association of Taxation Technicians

4 Note

4.1 The Association is a charity and the leading professional body for those providing UK tax compliance services. Our primary charitable objective is to promote education and the study of tax administration and practice. One of our key aims is to provide an appropriate qualification for individuals who undertake tax compliance work. Drawing on our members' practical experience and knowledge, we contribute to consultations on the development of the UK tax system and seek to ensure that, for the general public, it is workable and as fair as possible.

Our members are qualified by examination and practical experience. They commit to the highest standards of professional conduct and ensure that their tax knowledge is constantly kept up to date. Members may be found in private practice, commerce and industry, government and academia.

The Association has more than 9,000 members and Fellows together with over 6,000 students. Members and Fellows use the practising title of 'Taxation Technician' or 'Taxation Technician (Fellow)' and the designatory letters 'ATT' and 'ATT (Fellow)' respectively.