



Basis period reform Consultation

Response from ICAS

By 31 August 2021

About ICAS

1. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants. We represent over 22,000 members working across the UK and internationally. Our members work in the public and not for profit sectors, business and private practice. Approximately 10,000 of our members are based in Scotland and 10,000 in England. ICAS has a public interest remit, a duty to act not solely for its members but for the wider good.
2. The following submission has been prepared by the ICAS Tax Board. The Tax Board, with its five technical Committees, is responsible for putting forward the views of the ICAS tax community; it does this with the active input and support of over 60 committee members.

General comments

3. ICAS welcomes the opportunity to respond to the consultation 'Basis period reform' issued by HMRC on 20 July 2021.
4. We were disappointed at the very short six week consultation period, particularly during the summer holiday period. It is important that proper consideration is given to the proposed significant changes.
5. Basis period reform itself is to be welcomed as a sensible move towards an efficient modern tax administration. Concerns from members about basis period reform are largely to do with the interaction between basis period reform, the start of MTD for ITSA quarterly reporting and HMRC service standards.
6. The sheer volume of change, over a short period of time, will have an impact on HMRC resourcing and service standards. There are also concerns about the additional workload for professional firms, and the cost and planning implications, particularly for certain groups of businesses.
7. The concerns are mainly under six headings:
 - HMRC resourcing – particularly if all businesses start MTD ITSA quarterly reporting on the same day and with the same quarters
 - The availability of the pilot and cost of appropriate software
 - The impact on professional firms and their clients
 - Penalties and the need for a 12 month soft-landing period
 - Additional tax bills for the transitional year due to erosion of the value of overlap relief
 - Increasing complexity and the need for simplification
 - amending returns, and
 - taxation as a single business unit.

HMRC resourcing – particularly if all businesses start MTD ITSA quarterly reporting on the same day and with the same quarters

8. Concerns over delays in routine processing are regularly being received from professional firms. While the outstanding achievement of HMRC in delivering coronavirus support is acknowledged, there are widespread concerns that this was achieved largely through reallocation of resources from other areas, with a detrimental and ongoing effect on service levels.
9. HMRC appears to be under resourced to tackle the job in hand and to provide acceptable service standards. How will HMRC cope with the inevitable surge in demand if MTD for ITSA arrives with a 'big bang' start for all businesses in April 2023?
10. To take a recent specific example, a firm reported that it was advised by HMRC that it is taking up to 6 months to set up a UTR reference for new Self Assessment clients.

11. The firm commented that 'I am concerned with the possible chaos and unworkability of April 2023 for Making Tax Digital for Personal Tax, together with the impact of the HMRC Basis Period proposals. HMRC at the senior board level need to realise the challenges being faced on the ground within HMRC, its lack of capability just now and also the additional strain these proposals will put on an already strained group of agents around the UK'.
12. Delays are also being seen in other areas, such as compliance work and repayments. This is basic bread and butter work.

The availability of the pilot and cost of appropriate software

13. There is considerable uncertainty about what is currently available in terms of software, what will be available in time for larger numbers to join the pilot, limited numbers of software developers in the field and uncertainty over costs.
14. Few businesses are currently able to join the pilot. Many, such as those claiming coronavirus support, are excluded. The timescale is becoming too compressed for the majority of businesses to adequately test their systems. The ideal of having 12 months' experience within the pilot is becoming unachievable.
15. The reach on MTD ITSA means that some very small businesses are within scope. It can be particularly difficult in rural areas where individuals may have four, five or more different income streams, embracing self employment, property and employment income, but overall earn little more than the national average wage. Basic issues, for example, how many software licences may be needed by an individual small business which has multiple income streams, are still unclear.

The impact on professional firms and their clients

16. One firm commented: 'currently it is the glue of the agent that is keeping the HMRC machinery fit for purpose, if more pressure is placed on that, for example roll out of MTD in April 2023 and basis period proposals, then there must be concerns how agents around the UK could manage. We are already underway with mapping out what this would look like for us and our clients and the bunching together of the work is a concern'.
17. For small and medium size businesses, many of whom will have to delegate this work to their agents, the changes will mean additional costs. Many of these agents are already under great pressure and there seems to be a shortage of available staff.
18. A number of firms have commented that many SME businesses are likely to move to a 31 March year end, in the light of the proposals. This will create resourcing issues for firms with more work being concentrated into a shorter period.
19. A key concern is certainty. Firms are encouraging businesses to prepare now, and want to work to an agreed and fixed timetable. Last minute changes are most unwelcome.

Penalties and the need for a 12 month soft-landing period

20. If MTD and basis period reform go ahead with a 'big bang' from April 2023, there should be a 12 month soft landing period for penalties. Applying the new points-based penalty regime in the first year would not be a good idea – it would add another new set of rules for people to get to grips with.

Additional tax bills for the transitional year due to erosion of the value of overlap relief

21. The impact of the erosion of overlap relief is likely to be concentrated in specific sectors, professional partnerships with a 30 April year end, being a prime example. The additional tax due as a result of the proposals is significant and many firms report that an extended period of up to ten years over which additional profits can be spread will be needed. This is covered in the response to section 4 below.

Increasing complexity and the need for simplification

Amending returns

22. For businesses other than those with a 31 March/5 April year end, the proposals bring complexity rather than simplification. This is due to the requirement to apportion accounts to match the tax year, and the need to file returns by the current self assessment filing deadline of 31 January. For business reasons, not all entities are free to change their year end to align with the tax year.
23. Much of the negative impact here could be avoided if businesses were permitted to make adjustments to initial estimates in the following year's tax return, rather than by amending the current year tax return. For example, a business preparing accounts to 31 December 2024, might be permitted to include any adjustment to the estimated profits for the period January to March 2024 in the 2024/25 tax return, rather than through amendment to the 2023/24 return. Such businesses would normally have management accounts available on which to base such estimates.
24. For large partnerships, where otherwise personal self assessment tax returns for a significant number of partners would need to be revised and resubmitted following any revision of the partnership return, the administrative savings for both taxpayer and HMRC would be substantial. Savings would include avoidance of administration costs for HMRC for collection or refund of minimal amounts of tax, consequent on amendments to estimated tax returns.
25. The impact on certainty and enquiry windows should not be overlooked.

Taxation as a single business unit

26. Looking towards quarterly reporting under Making Tax Digital for Income Tax, alignment of the assessment basis for different sources of income, as noted above, is generally beneficial. Yet to leverage the advantages of such alignment, consideration also needs to be given to taxation of multiple profit sources as a single rural business unit.
27. This scenario encompasses large estates, farming partnerships and crofters. Many land-based businesses increasingly have multiple sources of income. These can range from renewable energy, to farming, tourism, holiday letting, B&B and unfurnished property lets. In some cases a single individual or partnership might have four or five different sources, all potentially reportable separately under Making Tax Digital for Income Tax. The total profits from all sources, in many cases for small rural enterprises, providing an income of no more than the national average wage.
28. It would be a significant simplification if such businesses could report all income as a single trade per rural business unit. With the alignment of basis periods, this becomes an achievable goal.

Section 3. Proposal: The tax year basis

Question 1: 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?

29. The tax year basis seems a sensible approach and removes a number of complications and anomalies which have been in the system for a long while.
30. We support this reform; our concerns are with the timing of implementation alongside MTD for ITSA as discussed above.

Question 2: 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?

- 31. Comments so far from our members indicate that many smaller businesses are likely to opt for a 31 March year end. There are a number of specific groups of businesses however which are unlikely to adopt 31 March. These would include international business groupings and some seasonal (particularly tourism and hospitality) businesses.
- 32. Under Making Tax Digital, an unfortunate and inherent conflict will arise between optimal accounting year end for tax reporting and that for business monitoring and management. For example, many tourism related businesses would benefit from a 31 December year end from a management perspective, but this would cause unwanted complexity and administrative costs on an ongoing basis for tax reporting.

Question 3: 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?

- 33. The costs are likely to be determined by whether the business is able to deal with tax consequences in-house or if they will need professional help from a firm of accountants. This means that larger businesses may be better placed to manage the cost implications than some SMEs, which would need to source outside help on an ongoing basis.
- 34. The administrative burden will be particularly impacted by the specific year-end date. Businesses which would need to submit estimated figures - for example, businesses with a 31 December year end - will face additional administrative pressures and costs, due to the proximity of their year-end to the self assessment 31 January filing date.
- 35. Specific easements might be appropriate for selected groups, such as a short extension to the filing date for the final return in exceptional cases.
- 36. Additional administrative costs of apportioning profits and revising returns have been estimated by some firms to be in the range £1,000 to £3,000 per SME business, with large partnerships facing higher costs.

Question 4a: 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?

- 37. The position here is likely to depend on a number of factors including the availability of professional support, the complexity of the business, and international implications. It would be difficult to give a hard and fast rule as to precisely which year ends would be affected.
- 38. The biggest determinant is likely to be business complexity. Businesses which are able to move to 31 March to simplify calculations are likely to do so. It follows that those which don't are likely to have particular reasons why it is not practicable or possible to do so.

Question 4b: 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?

- 39. Possible costs associated with apportioning profits have been noted above. No separate estimate is available for estimation of profits. As noted in the introductory comments, permitting adjustments to be made in the tax return for the following year, rather than by revising returns already submitted would very significantly reduce administrative burdens.
- 40. Changing the tax year end to 31 December might be an effective alternative solution.

Question 5: 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?

41. Equivalence of 31 March and 5 April, in the absence of a more radical solution such as changing the tax year end, is to be welcomed. Extension to property income is appropriate. In many cases it would clarify the position for property businesses whose software is not designed to report other than to month ends.
42. Alignment of basis periods for different income sources is sensible and brings welcome transparency to income tax calculations. Many individuals have multiple sources of income. Indeed in many rural areas self employment itself can be a mosaic of different businesses all operating on a small scale.
43. The alignment goes wider than quarterly reporting. Many self employed individuals also have employment income and allocation of allowances and tax bands would be facilitated through the proposed equivalence approach.

Question 6: Are there any specific issues, costs, or benefits to the tax year basis for partners in trading partnerships?

44. Adopting a tax year basis offers simplification for partners joining and leaving partnerships. The abolition of overlap relief is a significant simplification. The simplification extends to rules for other income.
45. Costs centre around the increased tax bills likely in the transitional year. Many large partnerships have year ends early in the tax year, for historical reasons. The value of overlap relief has been eroded by time and inflation. Some firms have indicated that a ten year spreading period for excess profits following the move to tax year basis would not be unreasonable.

Question 7: 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?

46. Paragraph 3.33 invites comments on occasions where basis period reform may interact with other areas of tax. These could include:
 - capital allowances
 - cash basis
 - losses
 - other claims and elections
 - payment of tax and payments on account
 - Double Taxation Relief
 - trusts and estates with trading income
 - non-resident companies charged to income tax
 - averaging of fluctuating profits
 - National Insurance Contributions
 - student finance repayments
 - Tax Credits
 - High Income Child Benefit Charge
47. There is a basic mismatch between quarterly reporting and the fact that income tax is based and calculated on a period of time – the tax year.

Gig economy and people who are 'in and out' of work

48. For micro entities, and particularly for individuals who lack job security and are both employed and self employed, HMRC (under MTD quarterly reporting) will be monitoring life events in real-time. This is likely to bring challenges. For example, were an individual to be self employed for three

months, then employed for 2 months, out of work for a month and self employed again for the balance of the tax year, how would this fit within quarterly reporting?

49. With a growing 'gig economy' there may be a lack of clarity regarding the income tax reporting regime that applies to these individuals – leading to confusion, lack of compliance and no doubt penalties. There is a need to address the status of those who sit between employment and self employment, where some may end up 'in and out' of quarterly reporting, and unclear about their reporting obligations.

Capital allowances

50. For large entities with an in-house team, or for SMEs with appropriate external professional support, forecasting the impact of capital allowance claims and other annual adjustments is not beyond the bounds of possibility.

Foreign tax credits

51. No comments.

Section 4. Implementation and transition

Question 8a: 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?

52. The proposed approach is not unreasonable in principle. However overlap relief for many businesses has 'withered on the vine'. Coupled with this, the fact that businesses will not be able to choose when to use their overlap relief, or manage the potential impact, means that the impact may be unduly severe in many cases for long established businesses.
53. In practice, many businesses may opt for a short, rather than a long accounting period if changing their accounting year end. This has implications for costs, business management and workflow.

Question 8b: Are there any other specific circumstances on transition to the tax year basis that would require additional rules?

54. No comments.

Question 9a: 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?

55. Spreading the profits is appropriate. However, consideration should be given not only to businesses incurring additional tax bills in the transitional tax year, but also to those changing their year end (and soaking up overlap relief) in an earlier year in preparation for MTD quarterly reporting from April 2023.

Question 9b: 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?

56. As outlined above, some long established businesses with year ends early in the tax year, might need up to ten years spreading of excess profits.
57. It would be appropriate for five years to be available to all affected businesses, with ten years available in exceptional circumstances. Exceptional could be defined as a set percentage increase in chargeable taxable profit.
58. While overlap relief provisions were designed to achieve the outcome that a business would be taxable on exactly the profits earned over its lifetime, this does not translate into equivalence of

tax due. This is because spikes in profit are likely to attract higher rates of tax, owing to the incidence of tax rates, bands and allowances. The transitional year spike is one which is thrust upon businesses without regard to circumstances and with potentially inequitable outcomes.

59. Higher tax rates on profits in the transitional year, resulting from the fall in the relative value of overlap profits, are not compensated for by any adjustment to rates and bands.
60. By contrast, in the normal course of events, overlap relief might be claimed on retirement, or as business activity is wound down. The erosion by inflation of the value of overlap relief in such a scenario would not automatically translate into higher tax rates, due to the lower overall rate of business activity.

Question 10: Are there any other impacts, benefits, or costs in the core policy, transition, or mitigation proposals that we have not considered above?

61. No comments.

Section 5. Assessment of impacts

Question 11: Please tell us if you think there are any other specific impacts on other groups or businesses that we have not considered above.

62. No comments.

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