

## **Do unincorporated businesses need to change their yearend because of Basis period reform?**

HMRC have recently announced a change in the way unincorporated businesses are going to have to allocate their trading profit to tax years for their tax returns. In effect the profits shown on tax return will be based upon the tax year to 31 March or 5 April instead of being based on the businesses' own yearend. This will take effect for the tax year 2024/25 however the transition year will be the tax year 2023/24. If your year end is already 31 March or 5 April, then this change will have no impact on you. This change will only effect unincorporated businesses and so if you trade through a limited company again this will not affect you.

Generally, businesses produce accounts up to the same date each year. As an unincorporated business you are allowed to choose any year end date that you like. In practice the most common choices are the 31 March or 5 April as this corresponds to the tax year or 31 December being the end of the calendar year. Currently your year-end can have an effect on the tax you pay because of how the year end profits are included in your tax return.

At present when you first start a business the profits from the commencement of the business until 5 April are taxed on your first tax return to 5 April. In subsequent years you look back to see if there is a year-end in the last tax year, and it is those profits that are included on your tax return.

For example, if you started your business on 1 June 2020 and had a year end of 31 May 2021 the periods entered on your tax return would be as follows:

Tax return to 5 April 2021 – Profits shown for the period 1 June 2020 to 5 April 2021

Tax return to 5 April 2022 – Profits shown for the year ending 31 May 2021.

Tax return to 5 April 2023 – Profits shown for the year ending 31 May 2022.

You will see that the profits for the period from 1 June 2020 to 5 April 2021 are taxed twice as they are included on the tax return to 5 April 2021 and represent most of the year shown on the tax return to 5 April 2022. These are called overlap profits and are normally released when the business ends or if it changes its year end closer to 5 April or 31 March.

You may think that nobody would want a 31 May year end if a large proportion of those profits are going to be taxed twice but, in many cases, it makes a lot of sense. If the initial years profits are low or the business made a loss, then the overlap profits would be very low or there would be none. Then going forward, it would be your 31 May year end profits that would be declared on your tax return to 5 April the following year. Any tax on these profits would be payable 31 January the year after that. Therefore, the tax payable on the profits made in the year to 31 May 2022 would not be payable until 31 January 2024. This represents a cash flow advantage as there is such a long time between the year end and the date that the tax is payable.

When the Basis period reform comes into force on 6 April 2024 your year end will, in theory, have no effect on the profits declared on your tax return as the profits declared will be the profits generated for the tax year to 31 March 2025 or 5 April 2025, regardless of the businesses' own year-end.

Businesses can still prepare accounts to the same year end they always have done but if they do they will have to adjust their profits so that the profits generated in the tax year to 5 April or 31 March are reported. In our example above this would mean that 2/12<sup>th</sup> of the profits for the year to 31

May 2024 plus 10/12<sup>th</sup> of the profit for the year end 31 May 2025 would be shown on the tax return to 5 April 2025.

It is likely to be much simpler for businesses to change their year end to either 5 April or 31 March each year to avoid the unnecessary process of allocating profits from one year end to two different tax years. This change needs to be done in the transition year which is the tax year to 05 April 2024 or 31 March 2024. In this year you can either prepare an extra short period of accounts or extend the period so that you have a period that ends on 31 March 2024 or 5 April 2024.

The change will mean that businesses affected by the change will have two chargeable periods in one year which may increase the tax payable in that year. You will be allowed to offset any overlap profits that were generated when the business started but it is still likely to increase the tax liability for that one year. As a concession HMRC are allowing any extra tax that is generated because of this change to be spread over five years.

For more help or advice about any of the ideas covered in this guide, Westcotts is here to help. To contact a member of our team for further advice please find the contact details of your local office on our website by following this link. <https://westcotts.uk/contact-us/>