MTD ITSA and Basis Period Reform - Update

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Contents

Key Points

- MTD ITSA – Delayed for two years, comes into effect from the 2026/27 tax year. There is not much change for those MTD VAT compliant other than additional reporting requirements

- Basis Period reform may result in 23 months of profit (based on 30 April year-end) becoming assessable in the 2023/24 tax year, subject to adjustments (see recap below). The first tax payment being affected is on 31 January 2025.

- Should you consider changing your accounting year-end?

- Should you consider syncing your VAT quarter ends with the MTD ITSA quarter ends and using the equivalence rule?

Basis Period Reform – Update

With the announced delay in MTD ISTA before Christmas, I suspect everyone breathed a sigh of relief, assuming that the basis period reform would also be delayed. Especially given HMRC's narrative that basis period reform was necessary for the successful implementation of MTD ITSA.

However, the announced delay did not include Basis Period Reform when looking at the finer details in January. It will go ahead as planned with the transitional period in the 2023/24 tax year.

This results in potentially 23 months of income (based on a 30 April year-end) being assessed in the 2023/24 tax year, with 31 January 2025 is the first tax payment affected.

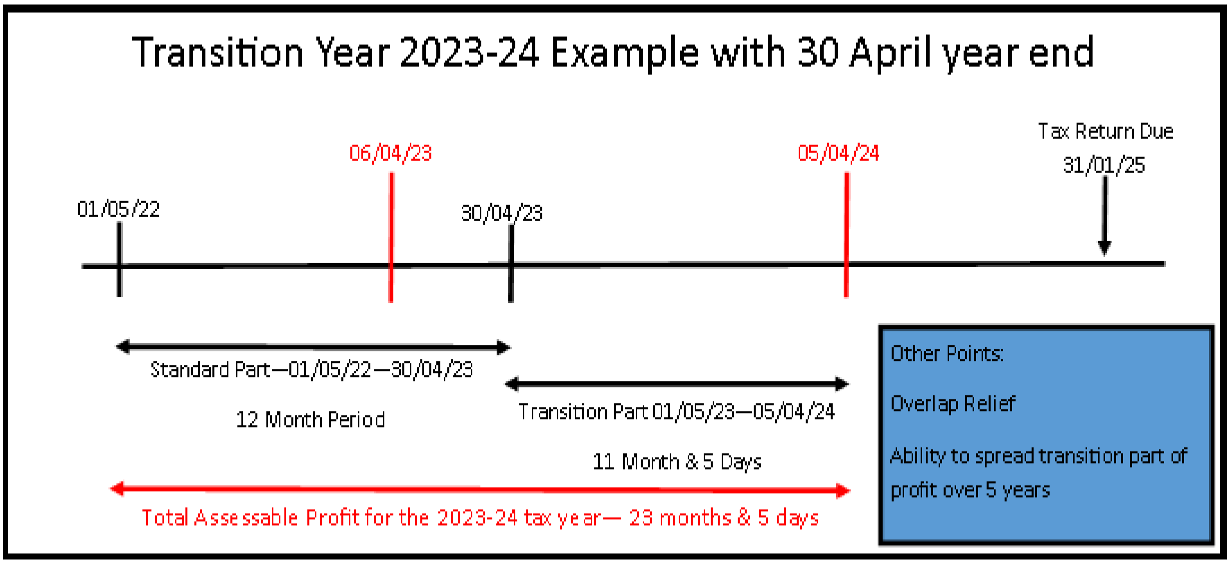
Basis Period Reform - Recap

You are currently taxed on the accounting period ending within the tax year. Many people opt for an accounting period early in the tax year, typically 30 April, as it provides the following benefit:

- Cash Flow Management – by having a year-end early in the accounting period, you are essentially paying tax on profits almost a year later than if you had a year-end the same as the tax year. You can also have a very reliable estimate of your tax liability up to 18 months in advance.

- Pension Planning – by knowing your assessable profit for the tax year before the tax year ends, you are aware of your effective tax rate and can make tax-efficient pension contributions.

However, from the 2024-25 tax year, you will be taxed on profits that fall within the tax year. With 2023-24 being a transition year. The main impact of this is that you may end up paying tax on up to 23 months of income in the 2023-24 tax year (based on the 30 April year-end). Please see the example below:



From the above example, you will see the following:

- Standard part - of assessable profit will be your usual period 01/05/22 – 30/04/23.

- Transition part – of assessable profit will be the period from the end of your accounting period to the tax year end, 01/05/23 – 05/04/24.

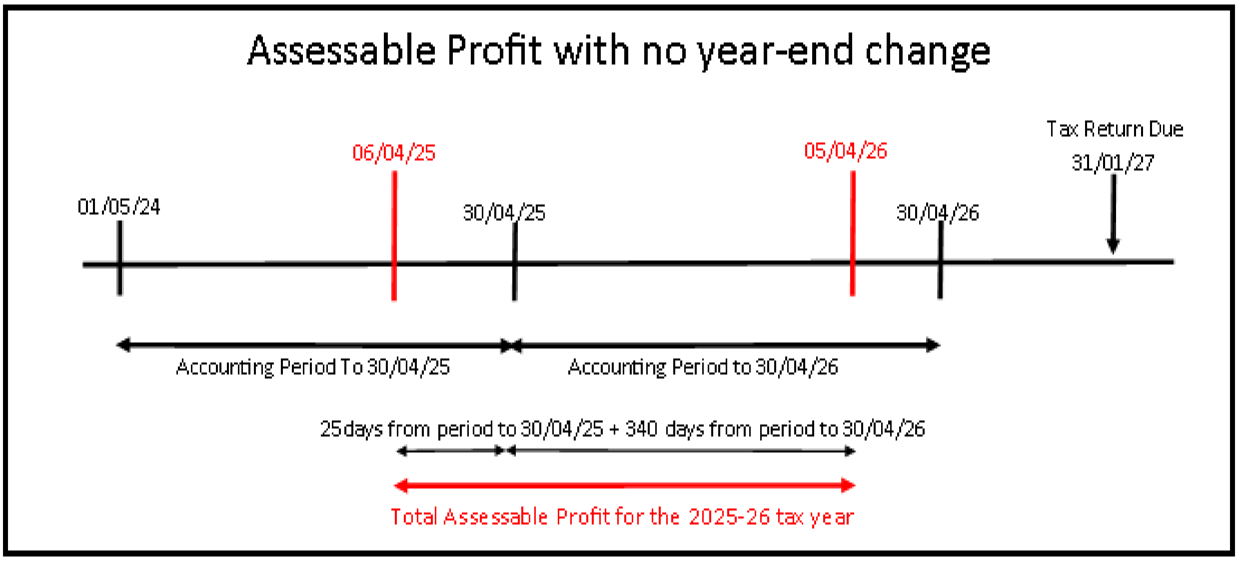
- Total assessable profit – for your 2023-24 tax return will be from 01/05/22 – 05/04/24.

- Overlap relief - will be deducted from the transitional part of the assessable profit. It will be removed on the transition to the new basis of taxation, so you will lose it if it is not used.

- Spread transitional profit – there is the opportunity to spread the transitional profit (less overlap relief) over five years, with the first period being 2023-24.
    - There is no ability to spread transition losses if year-end is changed before 2023-24.
    - The treatment is similar to the Catch-up charge.

Should you change your accounting year-end?:

Under the new basis of taxation, if your year-end is not in line with the tax year, you would have to proportion profits from two separate accounting periods to arrive at the assessable profit for a tax year. Please see example below:



From the above example you will see the following:

- Assessable profit for the 2025-26 tax year would be based on the following:
    - Accounts to 30/04/25 – 25 days
    - Accounts to 30/04/26 – 340 days

- Estimates – for the latter set of accounts you may need to use estimates if they are not complete in time for the tax return deadline, this will be a particular problem if you have a year-end later in the tax year. Estimated figures will then need correcting at a later date. How this will be achieved is still under consultation.

How does this affect you?

There are varying factors that will determine the scale of the effect MTD ITSA will have on you. Such as:

- MTD VAT – how you currently comply with MTD VAT

- Accounting Year-End – Basis Period reform could significantly impact your affairs depending on your year-end.

- VAT Quarter Ends

Please note that these changes will not affect the due date of any tax liabilities. You will not have to make any quarterly payments with the submissions; payment dates will remain on 31 January and 31 July.

MTD for VAT:

- Record Keeping - Not much will change if you have been using MTD software for VAT. You will already be keeping digital records for VAT purposes with software that has an API link to HMRC. Many major software providers will have an API link with HMRC for MTD ITSA when it comes into effect. Below is a link to software providers currently working with HMRC:

https://www.gov.uk/guidance/find-software-thats-compatible-with-making-tax-digital-for-income-tax

Accounting Year-End:

- Basis period reform will cause numerous complications for anybody that does not have a 31 March or 5 April accounting year-end. Many of the benefits of having a varying year-end will be negated, so it may be worthwhile considering a change of accounting year-end to avoid these complications.

- Remaining on a none 31 March or 5 April year-end will result in proportions of two different sets of accounts being used to calculate assessable profit.

VAT Quarter Ends:

- Sync quarter ends – Between VAT and Self-assessment, eight quarterly submissions will be made. Syncing your VAT quarter with the Self-assessment quarters (above) may be worthwhile to simplify your affairs and negate the need to deal with eight varying deadlines throughout the year.

For more information tailored to your specific circumstances, please get in touch with Peter Ward via:

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