Act now to ensure a smooth transition to new income tax basis period rules

We examine changes in tax reporting and the preparations businesses can make to cope with possible cashflow challenges.

Unincorporated businesses are now entering their first taxable period under new basis period rules, potentially impacting cash flow for some.

The changes affect the tax reporting for self-employed individuals, partners, trusts and estates with trading income. They involve aligning your basis period with the fiscal year, so profits are taxed within a fiscal tax year regardless of the accounting period.

Due to be implemented in the 2024/25 tax year, with 2023/24 as a transitional year, the transitional taxable period therefore runs from the start of a business's basis period in 2022/23 to 31 March or 5 April 2024.

Businesses that don't have a 31 March or 5 April year end will need to add additional months into the following year's profits and will potentially face tax on up to 23 months' profit in one year.

Cash flow challenges

This new tax basis could mean serious cash flow implications. The government recognises this and has indicated that all existing overlap relief that taxpayers have amassed should be used to help during the transition period – but this may not be enough.

As in our example, while previously profits earned in the period to June 2023 would have tax payments due in January and July 2024 (well after the period they were earned), a business will now be taxed on profits for the year to 5 April 2024 with the same payment dates. So, half the tax is effectively due three months before the period end, and half three months after.

Minimising the impact

Key essentials when preparing for the transition to a new basis period include cash flow projections, plus weighing up increased tax payments and when they will need to be paid.

If you are affected by these changes, get in touch with the Shipleys team.

How it will work

Sole Trader, Mrs X, draws up her trading accounts to 30 June every year and would normally have a tax liability for 2023/24 based on the accounting year ending 30 June 2023. With stable profits of £100,000 a year, the tax due would be around £31,800. This is paid on account in January 2024 and July 2024 – each for £15,900.

As this is the transitional year for these reforms, the actual taxable period would be 1 July 2022 to 31 March 2024, a 21-month period – and therefore £175,000 is taxable. The additional nine months' profit is by default to be spread over the following five tax years, so 2023/24 and the following four years will be taxed at £115,000 profits instead.

This would create a tax charge of £41,100 in each year, so she would have an additional charge of £9,300 in January 2025, and the payment on account instalments would rise to £20,550 for the next five years.

The additional tax paid would be £46,500, and future tax payments are made closer to the profits being made (see cashflow challenges in the section on the left).

However, the accelerated profits can be taxed earlier and, if they are all taxed in 2023/24, the year's tax liability is £70,800. This additional nine months of profit means £39,000 of tax is paid earlier in January 2025.

Note, the level of profit in this second example means spreading the profits results in a total of £46,500 in additional tax being due, rather than the £39,000 noted above, if all paid in the first year. So, in this example, spreading is more expensive and therefore electing to be taxed on more profit earlier could be more advantageous.

HMRC argues that such an individual would have nine months of overlap relief to use from the early periods of trading, and hence only 12 months are really being taxed in the transitional year. If in our example, however, the business made little or no profit in the early years (as many businesses do), there would be no reduction to the above.