Tax Talk

Simplifying the complexities of Tax

June 2022

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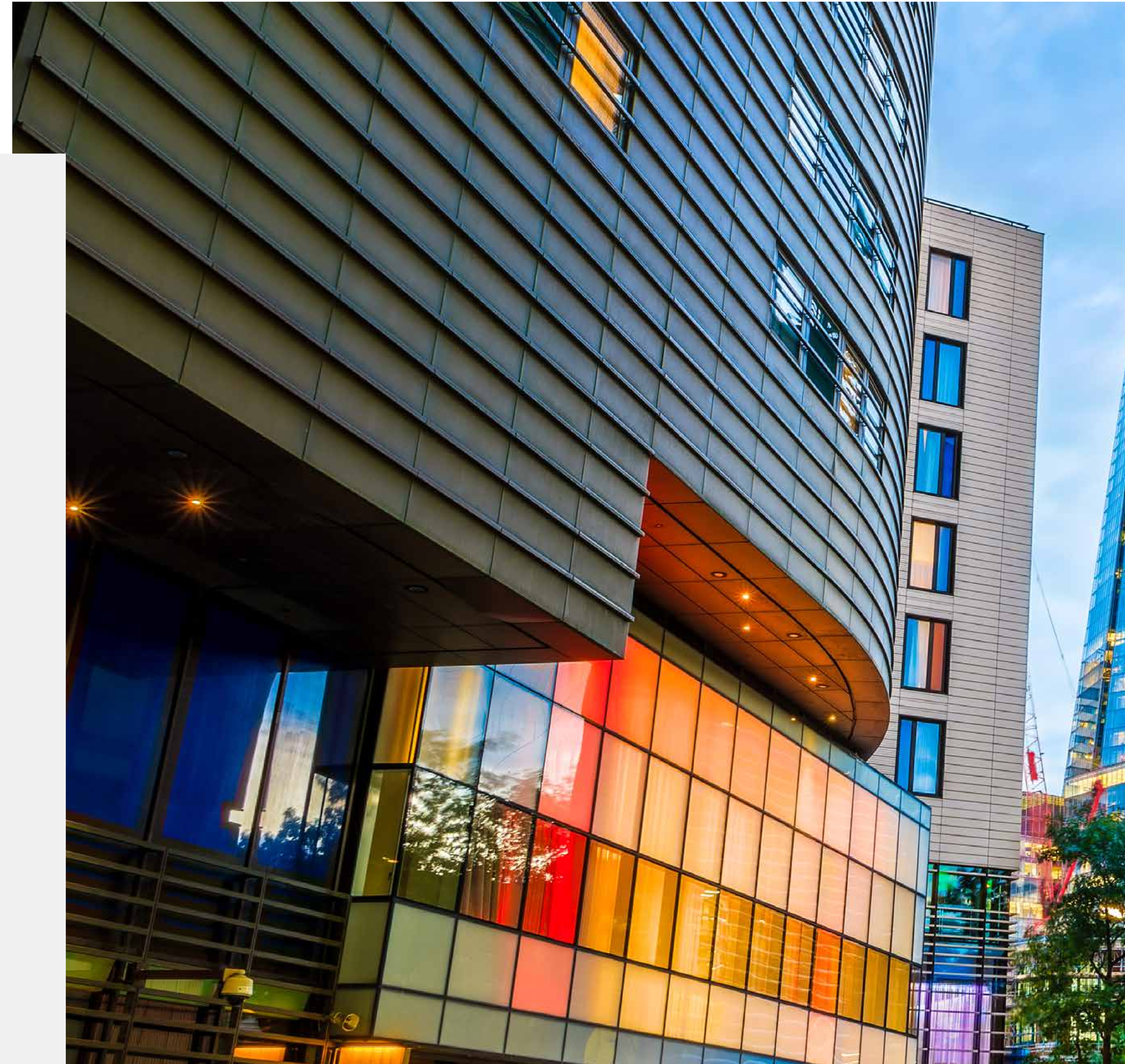

Basis period reform: what it means for your business

Sole traders and partnerships that do not use the traditional 5 April (or 31 March) year end will be affected by the Government's tax reform. We explain how.

The Government proposes to require all sole traders and partnership businesses to report their income and expenses on a 5 April tax year basis, beginning with the year 2024/25.

What is the current system?

Right now a business can choose any accounting year end. This is called the 'current year basis'. The basis period for a tax year is the 12 months ending with the accounting date in that tax year.

There are additional rules for the opening and closing years of a business, and when there is a change in the accounting period end.

The 'current year basis', creates overlap profits/periods where an accounting date other than 5 April (31 March is treated in the same way for these purposes) is chosen. Those overlap periods mean profits are taxed twice at the start in the opening years, with relief sometimes only being given many years down the line, when the business ceases, or the accounting date is changed to 5 April.

What are the proposed changes?

The proposed reform aims to make this system simpler by moving all sole trader and partnership businesses to reporting on a 5 April year end for the tax year 2024/25 onwards.

This will coincide with the introduction for sole traders of quarterly reporting of income and expenses to HMRC under Making Tax Digital for Income Tax.

There will be a transitional year in 2023/24, in which you will be taxed on your profits on the current year basis as usual, plus the transitional profits which arise in the period from the day after the current year basis ends to 5 April 2024. Any overlap profit brought forward will be deducted from the result. No further overlap relief can be claimed.

These transitional profits are treated as a separate item of taxable income when calculating the tax liability. They are left out of the adjusted net income figure used to calculate the taper of personal allowance or to trigger the High Income Child Benefit Charge.

The transitional profits will be spread over five tax years from 2023/24, with an option to accelerate the tax charge. The election can be made for any tax year, bringing an additional amount into charge for a specific tax year. This may be worthwhile if you have fluctuating profits or cash flow.

Here's an illustration of the changes for the transitional year:

Harry is a sole trader with the following profits:

y/e 30 June 2023	£115,000
y/e 30 June 2024	£150,000
Overlap profits brought forward	£55,000

The basis period for 2023/24 (the transitional year) is:

Current year basis – y/e 30 June 2023	£115,000
Transitional – 1 July 2023 to 5 April 2024 280 days/366 days x £150,000	£114,754
Less: overlap profit	(£55,000)
Transitional profits	£59,754

Harry's total taxable profit for 2023/24 is:

Current year basis	£115,000
One-fifth of transitional profits	£11,950
Total taxable profit 2023/24	£126,950

The transitional profits will be spread over five years. So an extra £11,950 will be taxable in each year from 2023/24 to 2027/28, unless an election is made for a specific year to tax an additional amount in that year.

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What if I have a loss in that transitional year?

Rules deal with losses arising in the periods that form part of the transitional year. There are prescribed steps for calculating the loss, and the element of the loss relating to overlap profits can be treated in the same way as a terminal loss, with potential to carry back for up to three years.

What if I don't want to change my accounting date?

It will not be mandatory for businesses to change their accounting date to 5 April. But if a business chooses for commercial reasons to retain its accounting date (say, 31 December), it will still have to report figures annually to 5 April.

This means having to apportion figures from the two accounting periods that fall within the tax year, in order to arrive at the figures that cover the year 6 April to 5 April (no apportionment will be needed for a 31 March year end).

In other words, for the tax year 2024/25, a business with a 31 December year end must report figures from the 2024 accounts for the period 6 April 2024 to 31 December 2024, and figures from the 2025 accounts for the period 1 January 2025 to 5 April 2025.

As the deadline for submission is 31 January 2026, it's highly likely the final 2025 accounts won't be available before the deadline, so figures will need to be estimated and provisional returns submitted to HMRC. The returns must then be amended once the final figures are available, which will increase the administrative burden and cost.

The Government believes around 528,000 sole traders and partners do not currently use a 5 April or 31 March year end. And, of those, around 278,000 (4% of sole traders and 17% of partners) will be hit by the need to prepare estimated figures, and submit amended returns later.

It therefore hopes as many businesses as possible will change their accounting date to come in line with the new rules. But, for some, external factors may mean a 5 April/31 March year end doesn't work.

What should I do now?

Make sure you understand the proposed changes and how they are likely to impact your business.

If you're not aware of having a record of any overlap profits, now would be a good time to start checking or contacting HMRC to see if they have details.

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In some instances, it may be beneficial to change your year end before 6 April 2023. But bear in mind you would then lose the opportunity to spread the additional profits over five years.

If you are intending to incur capital expenditure that would be eligible for capital allowances then the date you incur that expenditure may have a bearing on whether you get the relief in the year that you incur the expense, or if that relief is spread over the 5 years as part of the overlap profits. Therefore, any large items of capital expenditure may be best incurred in the "old" accounting period rather than have the expenditure fall into the transition period.

The position may also be impacted by whether you produce accounts for a long period of account, or two sets of accounts i.e. a 31 December year would mean that for the accounts starting on 1 January 2023, you could either prepare accounts for the 15 months to 31 March 2024, or two sets of accounts, one for the year to 31 December 2023 and one for the three months to 31 March 2024. The calculations for Capital Allowances will vary depending on whether you prepare accounts for a long period (time apportioned allowances), or two sets of accounts (allowances calculated in the period that the expenditure falls into).

It should be noted that periods of account exceeding 18 months are not recognised as a change of accounting date for tax purposes.

Explore whether a 5 April/31 March year end will work for your business from 6 April 2024. If it does, make the change so that from 2024/25 you can benefit from the new rules.

If the change in accounting date is not practical, plan how you will obtain figures in time to report them, and decide if you may be liable to file estimated figures.

Consider looking at draft figures in advance of the change, to give you an idea of the transitional profits that may arise, and the additional tax you'll need to pay each year for the five years. This will help you to budget.

It may seem like these changes are still some way off, but the transition year for those with a 30 April year end, started on 1 May 2022!

If you would like advice on any of the issues raised in this article, please contact Karen Ozen or Tilak Lamsal.

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Inheritance Tax and the modern family

With Inheritance Tax (IHT) thresholds frozen by the Treasury until 2025/26, now is a good time to consider IHT planning and to update your will. Andrew McCready explains some of the complications that may arise for LGBTQ+ families and couples not in a legal partnership.

Benjamin Franklin's much quoted words, "in this world nothing [can be] certain, except death and taxes," could have been so apt for Inheritance Tax (IHT). Except that IHT is both a death and a life tax, as it can also be charged on certain transactions during an individual's lifetime.

The Office for Budget Responsibility (OBR) expects IHT to raise £6.7 billion for the Treasury in 2022/23. Now that IHT thresholds have been frozen until 2025/26, we can expect that number to keep rising.

It's estimated that 31 million adults in the UK have not made a valid will. If you are one of these, and the worst happens, your estate may unintentionally suffer an IHT liability, and your assets may not pass to your chosen heirs.

If you are part of an LGBTQ+ family, IHT planning and drafting a will can be even more complicated. Although sexuality and gender identity, per se, are unlikely to be a key consideration when tax planning, there are some fundamental issues to consider.

Same-sex spouses and civil partners

Same-sex spouses and civil partners are eligible for the same IHT exemptions and reliefs given to opposite-sex spouses and civil partners. Generally, on death, assets transferred to a spouse or civil partner are exempt from IHT up to an unlimited value. The exception is where the estate passes from a UK-domiciled spouse or civil partner to a non-UK domiciled one. In this case, the exemption is limited to the available nil-rate band (NRB) and the spousal exemption of up to £325,000 each (unless you have made an IHT domicile election).

Similarly, where a residence that was once a spouse or civil partner's main residence is passed to a qualifying lineal descendent, they can benefit from the Residence Nil-Rate Band (RNRB) of up to £175,000 per spouse. Any unused NRB and RNRB on the first spouse or civil partner's death may be transferred to the surviving spouse or civil partner.

Same-sex spouses and civil partners also enjoy the same right to inherit a certain proportion of their partner's estate if they die without making a will, under the rules of intestacy.

Co-habiting families

Co-habiting families and couples who are not married or in a civil partnership cannot benefit from the unlimited spousal exemption. Any unused NRB and RNRB cannot be transferred on death to the surviving partner. This applies for both same-sex and opposite-sex partners.

A House of Commons briefing paper, Common law marriage and cohabitation (House of Commons Library, 4 May 2021) estimated that around 46% of same-sex couples in families were co-habiting in 2020 as opposed to 21% of opposite-sex couples in families. This means that LGBTQ+ families are likely to be disproportionately affected by the lack of reliefs for co-habiting couples and families.

If there is no will, partners are not automatically entitled to receive an interest in their deceased partner's estate. This means it's especially important for co-habiting families to make a valid will.

As for the RNRB, a scenario may arise if a couple with children are co-habiting. As an example, Alex is the legal parent of the children, but Geoff has no parental responsibility or guardianship for them, nor does he have children of his own.

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If Geoff died before Alex and left his former main residence to Alex's children, Geoff's estate would not benefit from the RNRB when calculating the IHT due on his estate. This is because, although Geoff has lived with Alex for several years and considers the children his own, legally he does not have parental rights or guardianship over them. This means they are not considered his lineal descendants for the purposes of the RNRB.

This creates a potential problem for couples with children where one party is not a legal parent or guardian, even if they in practice act as the child's parent. Both LGBTQ+ and non-LGBTQ+ couples with children should understand the implications and consider acquiring joint legal responsibility for the children as an appropriate tax planning step.

Same-sex parents and their child's domicile

Domicile is a common law concept that has been imported into the UK's tax system to determine an individual's liability to Income Tax, Capital Gains Tax and IHT. Please see Phil Clayton's article, When domicile doesn't translate to residency, for an explanation on domicile.

In general terms, on an individual's death, if they have a UK domicile their worldwide estate is liable to UK IHT. But if the individual has a non-UK domicile, only the estate's UK-situs assets are liable (ie assets situated in the UK).

Every child is assigned a domicile of origin at birth. It will remain with them for life, unless it's displaced by a domicile of choice or domicile of dependency.

A legitimate child's domicile of origin (where a child is born to or adopted by parents who are legally married or in a civil partnership) is generally acquired from their father. An illegitimate child generally takes theirs from their mother. However, the position becomes more complicated where a legitimate child has same-sex parents.

Under current law in England and Wales, a legitimate child's domicile of origin may not be determined if they have two mothers or two fathers. This is because their domicile cannot be acquired from both parents. In practice, this is only an issue if the parents have different domiciles.

This issue has yet to be tested in a court. Determining a child's domicile would ultimately come down to the facts of each case but could have far-reaching ramifications for the child.

It is clear the current law does not consider LGBTQ+ parents and their children and, without genuine reform, it's only a matter of time before these cases end up in court.

Wills and transgender family members

Since the introduction of the Gender Recognition Act 2004, people have been able to legally change their gender recorded at birth. The reassignment of an individual's gender can create difficulties regarding a person's will.

The Act came into force on 4 April 2005 and does not apply retrospectively. This means that wills written earlier will not recognise a person's new gender identity.

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For example, James and Sarah had two sons, Harry and Callum, and two daughters, Lucy and Emily. James and Sarah made mirror wills before 4 April 2005 leaving 50% of their estate equally between their sons and 50% equally between their daughters.

Several years later, Harry transitioned from male to female and changed their name to Harriet. They obtained a gender recognition certificate legally changing their gender.

As James and Sarah made their wills before 4 April 2005, Harriet would continue to be entitled to a share of the estate allocated to the sons, as before, because the change of gender would not be recognised.

But if James and Sarah had made their wills after 4 April 2005, their estate would pass to the beneficiaries in accordance with Harriet's legal gender. Therefore, 50% would pass to Callum and 50% would pass equally to Lucy, Emily and Harriet.

It's clear this was not the original intention of the will. The beneficiaries could apply to the courts to try to alter the distribution of the estate.

Failing that, they may enter into a Deed of Variation to alter the will and distribute it as was originally intended.

Regular updating of wills to reflect a beneficiary's change of gender is therefore important to avoid this confusion. Alternatively, it is recommended you use gender-neutral expressions such as "my child" or name the beneficiaries so it can be linked back to the intended recipient.

It's clear that the UK's tax system does not adequately address the differences in today's modern families. Current legislation has failed to keep up-to-date with society, directly and indirectly excluding LGBTQ+ families and individuals who are not married or in a civil partnership. Perhaps lawmakers should start considering how best to make our tax system inclusive for all.

For more information about the issues raised in this article, please contact Andrew McCready.

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Deemed supplies or self-supplies? Your questions answered.

Are you up to date with which party pays the VAT on an online purchase? And what happens in a case of self-supply? If not, here's a guide to common VAT scenarios.

The best things in life may be free but HMRC, like most of us, is rarely satisfied with just sunshine, love and the stars above. Indeed, in an effort to collect VAT beyond the classic 'supply and consideration' model, UK VAT legislation goes a step further to capture activities that might otherwise remain VAT-free.

Welcome to the complex area of deemed supplies and self-supplies.

What are deemed supplies?

Deemed supplies are transactions which would not otherwise be treated as supplies of goods or services but can be 'deemed' to be such. Examples of these are: accounting for VAT on business gifts; putting business assets to private or non-business use; and goods held at the time of de-registration.

The challenges of online marketplaces (OMPs)

HMRC is aware that advances in technology have dramatically impacted how businesses connect with consumers. So it is keen to harness – via the deemed supplier rules – the revenue-raising power of digital platforms that bring sellers and buyers together in a virtual marketplace.

Although the legal relationship remains with the real seller and the end-consumer, the OMP sometimes steps into the shoes of the seller for the purposes of VAT, depending on where the goods are located at the time of sale and on the profile of the customer, whether they are a business or a private individual.

If the goods are located in the UK, and the supply is made to a non-business customer (B2C), the supply between the seller and the OMP is considered to be zero-rated for UK VAT purposes and the OMP will be deemed to have made the supply to the UK customer. This means the OMP may need to register for, and account to HMRC for, UK VAT. The OMP doesn't take title to the goods but is still treated as the seller, with the obligation to collect VAT from the customer.

Where the goods are located outside the UK, and the value of the supply is under £135, the seller will be deemed to have made a B2B supply to the OMP (which falls outside the scope of UK VAT for both B2B and B2C transactions). So there should be no UK VAT obligations for the seller. The OMP is treated as the seller and must collect UK VAT from private customers and then pay it over to HMRC.

Deemed supplies or self-supplies? Your questions answered.

The case of self-supplies

Self-supplies, on the other hand, trigger a VAT charge so that goods and services are treated as both supplied **to** and **by**, that person. This ensures that there is no VAT saving in situations where VAT should not have been recoverable.

Consider a motor dealer who takes a car out of the forecourt to use it privately outside of the business. Since the dealership already recovered input VAT on the car's purchase, the now 'private' vehicle is effectively secured tax-free. To counteract this advantage, the dealer must account for output VAT on the self-supply to himself.

Beware self-supply charges

Ever since the introduction of VAT, there have been many examples where businesses have claimed input VAT relief under a relevant provision, only to be issued with a penalty notice for failing to account for output VAT under the self-supply rules.

In the case of Balhousie Holdings Ltd v CRC [2021] STC 753, HMRC attempted to claw back the benefit of zero-rating on the construction of a building used for relevant residential purposes.

HMRC claimed the appellant's sale and leaseback of a residential care home triggered a self-supply charge. But the Supreme Court ruled that the sale and leaseback transactions between the appellant and the counterparty should in fact be treated as a single transaction. This meant it was not a disposal of the entire interest in the property and that the self-supply argument did not apply.

The application of the deemed supply and self-supply rules to a company's circumstances can be complicated, and expensive if they are not implemented correctly. PKF's VAT team not only understands the intricacies of the regulations, but also has a wealth of practical experience on how HMRC is likely to react to a given situation.

We would not be surprised if there were a legal challenge to the OMP rules, which effectively make the OMP responsible for any VAT liability errors made by the seller in respect of goods sold via the OMP. Watch this space for further updates.

For more information on the issues raised in this article, please contact Natalie Braier.

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Global Indirect Taxes Webinars

We are delighted to invite you to register for a free series of Global Indirect Taxes webinars

The series will help you and your organisation navigate the significant changes that have been made to indirect taxes globally and provide an overview of technical and commercial considerations across all key jurisdictions.

Our webinars will also cover e-commerce, cross-border services, the concept of an establishment from a VAT and direct tax perspective, and customs duties. Attendees will be provided with real-world examples of how to minimise cross-border indirect tax issues.

Each event will be led by VAT Director, Luigi Lungarella who will be joined by indirect tax experts from across the PKF International global network, including the USA, Russia and the EU.

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Session 5 - 8th June 2022 - Cross-border goods – The hidden costs and challenges of Customs

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We provide a full range of audit, accountancy, tax and advisory services, and are experts at simplifying complexity – we're particularly well-known for working with large, high-profile businesses with challenging issues in fast-moving and highly technical areas.

We are also an active member of PKF International, a global network of legally independent accounting firms that gives us an on the ground presence in 150 countries around the world.

PKF in the UK

10th largest Tax practice in the UK

£182.5 million annual fee income

2,035+ UK partners and staff

6th ranked auditor of listed companies in the UK

Our tax services
At a glance

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We offer comprehensive tax compliance and advisory services to a range of clients, both in the UK and globally, helping them find their way in the increasingly complex world of tax.

We find practical solutions that we use to our clients' advantage. Our team of experts supports individuals, and businesses ranging from start-ups and SMEs to large international groups, both listed and privately owned.

Where understanding of our clients' sector makes the difference, our experts invest their in-depth industry expertise to provide invaluable support and insights.

We offer the following specialist tax services:

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Our Business Tax team will ensure that you are both tax compliant and efficient.

We provide specialist corporate and business tax advice on both a local and international level, which includes senior accounting officer and large business compliance, transaction services, due diligence, R&D tax relief, employer solutions and global mobility. We also support both the personal and business affairs of partnerships and LLPs.

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Personal tax and wealth management

Our team will guide you through the complex world of taxes, helping you meet all filing requirements and identifying risks and opportunities to help mitigate tax liabilities.

We advise individuals, the self-employed, partners, trustees and executors with their UK and international tax affairs. Our services include all aspects of tax, including Self Assessment, Capital Gains Tax, Inheritance Tax, property (both residential and commercial), trusts, family wealth and estate planning, residence and domicile issues.

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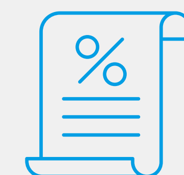

VAT and Indirect taxes

Our indirect tax team will support you in meeting your VAT compliance objectives and advise you on any VAT issues that your business faces.

We can ensure that your VAT risk is assessed and managed, and that your VAT recovery is optimised. We can also provide advice and compliance services on other indirect taxes, such as Insurance Premium Tax, Customs duty, and Air Passenger Duty.

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Tax disputes

HMRC is increasing the number and scope of tax investigations into both individuals and businesses, covering all aspects of potential underpayments of tax, including offshore investments, personal and corporate Self Assessment Tax Returns, PAYE and NIC compliance and VAT.

If an issue arises, our trusted advisors will match the right specialists with your needs to provide you the necessary support – whether for a routine HMRC enquiry or a more complex investigation.

Read more

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