HOW BASIS PERIOD REFORM FOR THE SELF-EMPLOYED MAY AFFECT TAX ON OTHER INCOME FROM APRIL 2023

Please call us for further advice

01743 241281 / 01952 216100

info@dykeyaxley.co.uk

DY

dykeyaxley

CHARTERED ACCOUNTANTS

Key Points

There are significant changes ahead in the way that the self-employed are taxed. This begins in April 2023.

Referred to as basis period reform, the changes mean that more tax may be due on income from self-employment, or a partnership, in the five tax years starting in 2023/24.

The impact will be felt by those using a business accounting year end other than 31 March or 5 April.

While it is clear that business income is affected, what may come as a surprise is that more tax may be payable on some other types of income as well, due to the changes.

Further guidance is awaited from HMRC, so the comments below should be taken as provisional. They provide an overview of the likely areas of impact, and those areas where no impact is expected.

If you think that these changes may affect you, please get in touch so we can review your tax position.

What to look out for

If you do not have a 31 March or 5 April accounting date for your business, an additional slice of trading profit is taxable in 2023/24. The amount of profit is called 'transition profit' and will run from the end of your usual accounting date up to 5 April 2024.

For example, with a 31 December 2023 accounting year end, profits for the period 1 January 2024 to 5 April 2024 are transition profits. These are taxed in addition to your normal annual profits.

Transition profit will be automatically spread over the five years to 2027/28, with 20% of transition profits taxed in each of the tax years.

It is possible to choose to be taxed sooner on these profits, with more than 20% being brought into charge in an earlier tax year, and the balance spread over the remaining years.

This may be advantageous in certain circumstances, for example if you know that your income is likely to increase and you would be liable to higher rates of tax in later years.

Which key areas are affected?

Two key areas of impact are restriction of the personal allowance and tax on savings income.

The personal allowance (the amount of tax-free income you are allowed each tax year) is reduced where taxable income is over £100,000.

Transition profits increase income for this test, so where inclusion of transition profits pushes total income over £100,000, personal allowance will be reduced. All the personal allowance is lost when income is over £125,140.

As regards savings income, the savings allowance (strictly a nil rate band), means that there is no tax to pay on the first £1,000 of savings for a basic rate taxpayer, or the first £500 of savings income for a higher rate taxpayer. Additional rate taxpayers do not get the savings allowance.

Where inclusion of transition profits brings total income into a higher tax band, savings allowance is reduced or lost.

A potentially unexpected area of impact is student and postgraduate loan deductions for the self-employed. These are based on total income. Unless rules are modified, this includes transition profits of the self-employed.

What is unaffected?

Special rules about how transition profits are taxed mean that some other items based on the level of income are not affected.

These include the high income child benefit charge, which applies where someone is in receipt of child benefit and they or their partner have income of over £50,000.

The £60,000 (£40,000 to 5 April 2023) cap for income tax relief on pension contributions is also unaffected.

Areas of uncertainty

As the legislation on transition profits is new, the impact on some parts of the tax code is unclear. HMRC guidance is expected, but in the meanwhile, there may be areas of uncertainty.

On a more positive note, transition profits should increase the total relevant UK earnings for the purposes of pension contributions and also increase the cap on income tax relief (which is based on the greater of 25% of adjusted total income / £50,000).

HMRC's initial indication is that the transferable personal allowance, often referred to as the marriage allowance, is available where transition profits push an individual into higher rates of tax, but only in the separate transitional profits calculation.

Planning opportunities

The timing of income peaks in relation to transition profits will be significant. There are a number of strategies available for managing taxable income. These include pension planning, use of gift aid to donate to charity, transferring income producing assets between spouses / civil partners and employing family members in a business.

Where there is discretion over the timing of income, for example with some trust income and family dividends, the best decisions will be made by keeping transition profits and spreading relief in view.

It may also be a good time to review property income portfolios to maximise the opportunities afforded.

Further information

This is a high-level overview, covering the main areas of impact. If you are a sole trader or partner in a partnership and think that these changes in rules may affect you, please get in touch so we can review your tax position.

Please contact us on

Shrewsbury 01743 241281

Telford 01952 216100

Email info@dykeyaxley.co.uk

DY

dykeyaxley

CHARTERED ACCOUNTANTS