



FINANCE (NO.2) BILL 2021-22: CL 94 & SCH 15: NOTIFICATION OF UNCERTAIN TAX TREATMENTS

Issued 12 October 2021

Text of ICAEW written submission to the House of Lords Economic Affairs Committee Finance Bill Sub-Committee **inquiry into Finance (No.2) Bill 2021-22: Basis period reform (cl 7 & Sch 1) and Large business: notification of uncertain tax treatment (cl 94 & Sch 15)**. Oral evidence was given on 11 October 2021.

The text of this written evidence submitted on 12 October 2021 following the giving of oral evidence on 11 October 2021 was prepared by ICAEW Tax Faculty. Internationally recognised as a source of expertise, ICAEW Tax Faculty is a leading authority on taxation and is the voice of tax for ICAEW. It is responsible for making all submissions to the tax authorities on behalf of ICAEW, drawing upon the knowledge and experience of ICAEW's membership. The Tax Faculty's work is directly supported by over 130 active members, many of them well-known names in the tax world, who work across the complete spectrum of tax, both in practice and in business. ICAEW Tax Faculty's Ten Tenets for a Better Tax System are summarised in Appendix 1.

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INCOME TAX BASIS PERIOD REFORM

1. *How far does the reform represent a useful simplification?*

1. Based on HMRC's figures, 93% of sole traders and 67% of partnerships already have an accounting year end that corresponds with the tax year end. This measure would therefore present no simplification for these businesses. For the others, while there is some complication in a business being taxed on the profits for the accounting period that ends in the tax year, once a business owner understands this, it should not present a major difficulty in determining their tax liabilities.
2. By contrast, switching to a system whereby a business must calculate taxable profits based on the profits of the two accounting periods contained within the tax year presents unnecessary further complexity. This is exacerbated by the fact that businesses will need to estimate and apportion the profits of the later accounting period if the final results for that period are not known at the time that the relevant in-year tax return or end of year reconciliation under Making Tax Digital (MTD) for Income Tax comes to be prepared.
3. We believe that this reform would not comply with our Ten Tenets for a Better Tax System, by which we benchmark the tax system and changes to it (summarised in Appendix 1), especially Tenets 3: Simple, and 4: Easy to collect and to calculate.

2. *To what extent would the reform deliver a fairer result than the current rules?*

4. The basis period method of taxation allows some businesses to defer payment of tax liabilities by choosing an accounting year end soon after 5 April. For example, the final liability for a business with a year end of 5 April 2021 would be due by 31 January 2022, whereas the liability for a business with a year end of 30 April 2021 would be due by 31 January 2023, a whole year later. Moving to a tax year basis would remove this effect and result in all businesses being taxed on the profits earned in the tax year, so closer to real time.
5. However, most businesses that choose a year end other than 5 April do so for practical or commercial reasons, rather than to defer tax. Those businesses would likely suffer an increased administration burden just because their accounting year end does not correspond with the tax year end.
6. It is also worth looking at this from the perspective of a large partnership, most of which have a 31 December or 30 April year end. If basis period reform was introduced, any such partnership would have only 10 months from the end of the tax year to prepare figures for partner tax filings, whereas the equivalent company would have 12 months to make the relevant tax filings. This differential is not a fair outcome.

3. *Would either of the alternative options mentioned in the consultation document be a better solution? If so, why?*

7. ICAEW does not believe that either of the alternative options set out the consultation document would be practical:
 - Mandating a tax year end accounting date would force many businesses to adopt a year end that does not work for them commercially or practically (eg farming businesses that tend to have a year end of 30 September to coincide with valuation of the year's agricultural crop).
 - Adopting an approach more akin to the corporation tax system would arguably be fairer than the current system as it would neither incentivise nor disincentivise any particular choice of year end. However, it would require significant reform of HMRC's IT and other systems to make this work and it could be difficult to integrate this approach with the normal deadlines for income tax reporting and may require extensive legislative reform to achieve (particularly the Taxes Management Act 1970).

4. *Are the transitional provisions sufficiently robust? If not, how do they need to change?*

8. In a **written ministerial statement**, the new Financial Secretary to the Treasury, Lucy Frazer, confirmed that if basis period reform goes ahead the changes will not be introduced until the start of MTD in 2024/25, with 2023/24 being the transitional year.
9. An announcement on whether basis period reform will go ahead is expected in the Budget on 27 October; **ICAEW's representation on the planned changes** made a firm recommendation that the proposals should be dropped.
10. If basis period reform is to go ahead in the manner set out in the consultation document, ICAEW considers that the transitional provisions on the whole provide a good balance of fairness and simplicity. They ensure that no tax revenue is lost and that most taxpayers do not lose out on the reliefs they are entitled to. The five-year spreading provisions will, in most cases, ensure that the cashflow impact of taxing more than 12 months' worth of profits in a year is satisfactorily mitigated. However, ICAEW also suggests a number of changes to enhance the fairness of the transitional provisions.
 - Businesses should be given the option to carry forward their unused overlap relief for use at a time that most benefits them, rather than requiring it to be used in the year of transition.
 - HMRC should ensure that it has sufficient records to advise businesses of the overlap relief available to them or substantiate the overlap relief records held by the business.
 - The legislation needs to make clear what happens if a business has a loss in the year of transition. ICAEW recommends that in those cases, the business should have the ability to carry back or carry forward this loss as in normal tax years and that they do not lose entitlement to their overlap relief just because they suffered a loss in the year of transition.
 - Further clarity is required as to how to deal with foreign tax credits and how this interacts with overlap relief both in the year of generation and the transitional year.
 - ICAEW recommends that business owners who cease trading during the five-year transition should be given the option to continue spreading the tax on the additional profits arising in the year of transition throughout the five years, rather than charged to tax in the tax year in which the trader permanently ceases to carry on the trade.
 - ICAEW also recommends that businesses that change their accounting year end to 31 March/5 April in advance of the basis period reform transitional year are entitled to spread the resulting overlap profits over five years in the same way that such profits can be spread where they arise in the transitional year.

5. *How onerous is apportionment of profits between tax years likely to be for businesses which do not have an accounting period aligned with the financial/tax year?*

11. As a general rule, the later a business' accounting year end is in the tax year, the more onerous it will be to apportion profits for the first part of that accounting year.
12. For example, in calculating the profits for the tax year 2024/25, a business with an accounting year ended 31 January 2025 would take 10/12ths of the accounting year profits to 31 January 2025, and 2/12ths of the profits to 31 January 2026. The final tax liability for the tax year 2024/25 is due by 31 January 2026. As this is the last day of the second accounting period on which the taxable profits are based, there is a clear practical difficulty. The profits for the accounting year ended 31 January 2026 may not be established for several months after the year end. An estimate of those profits will be required to complete the 2024/25 tax return. That return will then need to be resubmitted if those estimated numbers are superseded by final numbers, adding to the administrative burden of calculating the tax charge.
13. This issue is likely to be exacerbated for seasonal businesses such as tourism and farming whose revenue tends to be concentrated into a particular proportion of the year and whose profitability for a particular year may be dependent upon the weather. Many such businesses

draw up accounts to the time of the year in which business is quietest or stocks can be most accurately ascertained. Other businesses might have uncertain or erratic profits, such as medical professionals or entertainers whose sessions or performances can change significantly month on month.

6. *How manageable is the timetable, especially vis-à-vis the introduction of Making Tax Digital for income tax?*

14. ICAEW welcomes HMRC's announcement that MTD for income tax will be deferred for a year until 2024/25. If basis period reform were to be similarly deferred for a year, this would mean that the transitional year for this would be 2023/24 and would be fully in place for the first period under MTD.
15. While this timetable would give businesses an extra year to plan for this transition, ICAEW believes that it would be better if the tax year basis period reform were given some time to bed in first before MTD ITSA is introduced. HMRC, business owners, agents and software providers all need to feel comfortable that the new system will work as intended before it is introduced.
16. There is currently a pilot programme in place testing MTD for income tax but there are only a handful of businesses involved. The pilot needs to be expanded. Once the pilot has established that the new process is robust and easy to use, ICAEW recommends that at least one additional year before going live will be required to provide a manageable timetable for all stakeholders, including HMRC.

7. *What is Her Majesty's Revenue and Customs doing to support businesses in making the change?*

17. ICAEW greatly appreciates the dialogue that HMRC has engaged in with ICAEW and other representative bodies during the design of MTD ITSA. It has allowed us to put forward the views of ICAEW members and their business clients. HMRC has listened and has made some modifications in response (such as the announced deferral of MTD ITSA by one year). As mentioned in our response to question 6, only a handful of businesses are currently part of the pilot of MTD ITSA. While the pilot is being expanded to allow more taxpayers with additional income sources to join, ICAEW considers that significantly more businesses should be testing the system before it is mandated so that software providers and HMRC receive the necessary feedback and make changes accordingly.
18. Currently, most of the publicity for MTD ITSA is being left to third party software providers. ICAEW believes that before a new system of this magnitude is introduced, a full government information programme, supported by advertising through the press, will be needed. This should explain what to do to prepare and should allow businesses sufficient time to implement any required changes. HMRC should also make clear what safeguards will be put in place for taxpayers and their agents to file returns based on estimated figures without being penalised if the final figures prove to be substantially different.

8. *How important is reform of the basis period rules in the context of the Government's 10-year strategy for the tax administration framework?*

19. While basis period reform is mentioned in the [consultation document](#) issued earlier this year on the 10-year strategy, ICAEW does not consider that it is a central or essential element of that strategy. Indeed, it arguably goes against the aim of the 10-year strategy to provide a better experience for individuals and businesses as it either has no effect (ie, for those with fiscal year accounting periods) or it creates additional compliance burdens.
20. If HMRC views cash tax acceleration as an important benefit of the basis period reform, this cash acceleration can be achieved through other means and is in fact the subject of a separate Call for Evidence on Timely Payments.
21. Basis period reform is mentioned in box 4.1 on page 19 as an example of a simplification opportunity. The main complexities mentioned in the document arising from using the basis

period method relate to new businesses (ie, that they have a proportion of their early profits taxed twice through the operation of the commencement rules and that they then need to keep a record of the resulting overlap relief for future use when the business is wound up). For existing businesses, this complexity has already arisen and although they retain a requirement to keep a record of overlap relief, this is not a significant administrative burden (though we understand that it is a burden on HMRC that it would like to shed to keep the same records for its customers).

22. ICAEW's understanding is that the main driver for introducing basis period reform is to ensure that Making Tax Digital for income tax works efficiently and to eliminate the accrued overlap relief.
23. Irrespective of whether basis period reform is implemented, the MTD quarterly update requirement will be for standard quarters to 5 April, July, October and January with an option to elect to report to 31 March, 30 June, 30 September and 31 December. Therefore, introducing basis period reform would appear to be unnecessary to make MTD ITSA work, other than to encourage businesses to transition to tax year end accounting which means that their quarterly reporting obligations line up more closely with their accounting year end.

9. *How much of a problem are the existing basis period rules in practice?*

24. As mentioned in our response to question 8, the main complexity arising from the basis period method of taxation is where a taxpayer sets up a business with an accounting year end that is different to the tax year end. In the initial period of the business, part of the business' profits are taxed twice and then it needs to keep a record of that double taxation for the purposes of claiming overlap relief in the future. This can be avoided by businesses choosing an accounting year end that corresponds with the tax year.
25. Complications also arise in partnerships when partners join the partnership part way through the tax year.
26. An additional issue relates to businesses that make up accounts to 31 March each year. Strictly speaking, those businesses have an accounting year end that differs from the tax year end because 31 March is not the same as 5 April (even though there is only five days difference).
27. As part of the basis period reform and MTD for income tax proposals, HMRC has suggested introducing an equivalence rule, whereby both trading and property business accounts drawn up to 31 March could be treated as drawn up to 5 April. This proposed rule would be a simpler solution than basis period reform to resolve the problems encountered by businesses drawing up accounts to 31 March or another calendar quarter end.

10. *How does the proposal fit with the work the Office of Tax Simplification is doing on the date of the end of the tax year?*

28. In its publication *The UK tax year end date: exploring the potential for change*, the OTS acknowledges the short-term upheaval that changing the tax year end would create and in its summary findings, recognises that 'it would not be feasible to change the tax year end date before the scheduled 5 April 2023 start date of Making Tax Digital for income tax.'
29. ICAEW believes that, in an ideal world, the tax year end date should be changed in the first instance as this would facilitate the introduction of the other reforms. For example, aligning the tax year end with that of most other countries by changing to 31 December would make it easier for taxpayers with international affairs (including international partnerships) to calculate their offshore income and gains and any double tax relief associated with this. However, ICAEW recognises that this would defer the other proposed reforms further.
30. The OTS also notes, and ICAEW acknowledges, that the introduction of the equivalence rule mentioned in our response to question 9 would resolve some of the issues that having a tax year end of 5 April creates.

NOTIFICATION BY LARGE BUSINESSES OF UNCERTAIN TAX TREATMENT

- 1. *To what extent do the current proposals for notification by large businesses of uncertain tax treatment take account of concerns raised in the two consultations there have been on the measure?***
31. HMRC has listened to the concerns raised during the two consultations and has significantly improved the design of the regime by reducing the number of criteria under which a notification requirement would be triggered. However, one key concern – the fact that the criteria are inherently subjective – remains an issue. This is particularly in regard to the criterion added to the current draft of the legislation which requires a notification to be made where there is a substantial possibility that a court would find that a tax treatment adopted by a business would be found to be incorrect in one or more material respects.

- 2. *Is sufficient support being given to businesses to help them comply with the measure?***
32. HMRC has prepared draft guidance to assist businesses in understanding the new regime. ICAEW feels that the guidance is very clear and answers many of the uncertainties inherent in the legislation. However, there remain a significant number of uncertainties which ICAEW has highlighted in its representation which you can find [here](#). The main areas on which ICAEW feels HMRC could provide more detailed guidance are:
 - Practical details on when the three notification criteria apply including details of how to deal with contradictory HMRC guidance and examples of court cases where there was or was not a substantial possibility that a court would have found against the taxpayer.
 - Guidance on when a business might have a reasonable excuse for not making a disclosure based on its interpretation of HMRC guidance or advice from an accountant or lawyer that a tax position is not uncertain
 - Whether a disclosure under this regime would count towards the information provided to HMRC to prevent a discovery assessment being raised in respect of the relevant tax return.
 - What to disclose in situations where there are multiple alternative tax treatments.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory:** tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. **Certain:** in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. **Simple:** the tax rules should aim to be simple, understandable and clear in their objectives.
4. **Easy to collect and to calculate:** a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. **Properly targeted:** when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. **Constant:** Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. **Subject to proper consultation:** other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. **Regularly reviewed:** the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. **Fair and reasonable:** the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. **Competitive:** tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see <https://goo.gl/x6UjJ5>).