Government announces simplified tax reporting for self-employed and small businesses

- Self-employed and small businesses are set to benefit from simpler tax reporting rule

- New measures to clamp down on promoters of tax avoidance, including supporting taxpayers to steer clear and HMRC shut-down powers

- Research published on Making Tax Digital highlights benefits for VAT-registered businesses

The changes, which will come into force by 2023 and have been drawn-up alongside representatives of small businesses, will mean businesses will be taxed on profits arising in a tax year, rather than profits of accounts ending in the tax year. It should help them spend less time filing their taxes – aligning the way self-employed profits are taxed with other forms of income, such as property and investment income.

Financial Secretary to the Treasury Jesse Norman said:

> These complex rules lead to thousands of errors and mistakes in self-employed tax returns every year.
>
> Simplifying them will allow self-employed people to spend less time doing tax admin and more time growing their business and creating jobs.

Under the current system, tax returns filed by the self-employed, sole traders and partnerships are based on a business's set of accounts ending in the tax year (5 April). More complex rules apply when a business starts and draws up its accounts to a date different to the end of the tax year.

In those cases, taxpayers pay tax for their first tax year on the period to the end of the tax year, and then in subsequent years on the basis of their full accounting year, meaning profits are taxed twice and complex rules apply to relieve the double taxation when the business finishes.

These rules can be confusing to understand, particularly for new businesses, leading to thousands of errors and mistakes in tax returns. More than half of those affected do not claim relief they are entitled to and could pay tax twice.

The new system is easier for businesses to understand and will prevent thousands of errors every year.

The announcement comes as a number of documents are published by the government today, including draft legislation for the Finance Bill 2021-22 for technical consultation.

As part of this, the government has today also confirmed plans to make changes to the tax system to make the UK a more attractive location for asset holding companies (AHCs), which are used by certain types of funds. A response to the second stage AHCs consultation, which sets out the detail of the proposed regime, has been published, as well as draft legislation.

As part of today's announcements, the government is also delivering on its commitment to help protect UK taxpayers through clamping down on promoters of tax avoidance schemes. The package of measures announced today will be legislated for in the next Finance Bill (2021/22), and will:

- Tackle offshore promoters through hitting any associated UK entity with harsh penalties

- Support taxpayers to steer clear of tax avoidance schemes, or get out of tax avoidance quickly, by giving taxpayers more information on the false reality of what is being sold to them

- Clamp down on promoters who dissipate or hide their assets, by ensuring HMRC can protect its position and secure a promoter's assets to pay any relevant penalties

- Give HMRC tougher powers to shut down promoters that continue to promote schemes and sidestep the rules designed to restrict their activities and stop them from setting up similar businesses

A report on Making Tax Digital (MTD) for VAT-registered businesses has also been published by the government. The research, conducted externally, highlights positive developments in record-keeping behaviour and on the benefits MTD can deliver and is delivering for businesses.

Further information

For a full list of announcements from today's Legislation Day please see the Written Ministerial Statement here (https://questions-statements.parliament.uk/written-statements/detail/2021-07-20/hcws204).

In line with the Tax Policy Making framework, the government is publishing draft legislation to be included in Finance Bill 2021-22. This allows for technical consultation and provides taxpayers with predictability over future tax policy changes. The consultations on the draft legislation will run until 14 September, with measures included in the next Finance Bill.

The government is committed, where possible, to publishing most tax legislation in draft for technical consultation before the relevant Finance Bill is introduced into Parliament. This allows for transparent scrutiny of tax measures, giving greater certainty and stability to taxpayers.

Further information on Basis Period Rules and reform:

Overlap relief is normally given when a business changes its accounting date or stops trading, if two of its basis periods have overlapped in the past.

The current system is more complex for some businesses, as the time period of their accounts is different to the tax year. The reform will mean businesses pay tax on profits in the tax year they actually occur.

Example: A business draws up accounts to 30 June every year.

Currently, income tax for 23/24 would be based on the profits in the business's accounts for the year ended 30 June 2023.

Our proposed reform would mean the income tax for 23/24 would be based on: 3/12 of the income for the y/e 30 June 2023, plus 9/12 of the income for the y/e June 2024

The change announced today aligns with the government's plans to provide self-employed business owners with a more modern, digital, integrated service through the implementation of Making Tax Digital (MTD) for Income Tax. This will help reduce errors and ensure self-employed businesses get their tax right first time.

The change to the time periods against which businesses report their tax will also reduce the number of times those with several sources of income will need to report their income under MTD for Income Tax.