CLIENT FACTSHEET

Significant changes to how the self-employed are taxed from April 2023

Issued: September 2023

KEY POINTS

There are significant changes to the way that the self-employed are taxed from the year starting in April 2023. Before these changes the profits taken into account in a tax year were the profits of the accounting year that ended in that tax year. For example the profits for the year to 31 December 2022 are taxed in the tax year 2022/23.

The changes will mean that the self-employed will be taxed on the profits arising in a tax year. Therefore if a sole trader has a December year end the profits taxed in 2025/26 will be nine months of the profits to 31 December 2025 plus three months of the profits to 31 December 2026.

The transition between these two ways of taxing profits takes place in the tax year starting in April 2023 and could mean higher amounts of profits being charged to tax not only in the tax year 2023/24 but also in the following four tax years as the rules spread the adjustment over five years.

These tax increases may be relevant to you if your business does not have an accounting year end which coincides with the tax year ie it does not end between 31 March and 5 April inclusive.

The higher profits in these five years may also have other effects where your level of income is relevant for tax purposes as described below.

IMPORTANT - This information is for general guidance only so we recommend you speak to us to ensure you fully understand the impact of this information.

Why will there be **higher profits** charged to tax?

The tax year 2023/24 is a transitional year which aligns the profits in accounting periods with the tax years for accounting periods which do not end on 31 March-5 April. The taxable profits for 2023/24 will be those from the end of the period assessed in 2022/23 to 5 April 2024. For a 30 April year end for example this would be 23 months of profits (from 1 May 2022 – 5 April 2024).

As noted below there would be a deduction for overlap profits which arose in the early years of the business but if the business has grown these are likely to be much smaller than the extra profits coming into charge.

The extra profits less any overlap relief can be spread over five years starting in 2023/24 as long as the business does not cease, or the partner does not retire.

Under the old rules for allocating profits to tax years there were situations when businesses first started trading where profits were taxed twice. This happened when the accounting year end was not in the period 31 March – 5 April. In some cases, traders chose to have 30 April year ends to maximise the time between earning profits and paying the tax on those profits.

Where profits were taxed twice the amount was known as overlap profit and the old rules allowed a deduction for these profits when the business ceased or when the business changed the accounting year end.

Under the reforms to the tax rules these overlap profits will be allowed as a relief against the additional transition profits in the tax year 2023/24.

There may be some possibility to mitigate any overall increase in profits arising in 2023/24 and we would be happy to discuss these with you.

Does a business have to change its **accounting year end to match the tax year?**

No, a business can maintain an accounting year which does not match the tax year but for the purposes of completing the tax return, the business will need to apportion profits or losses to tax years.

Where an accounting period ends later in the tax year, eg 31 December the accounting period may not have ended when the apportionment is being done and so an estimation of the profits or losses would need to be calculated with a revised return being submitted once final figures are known.

This could add to the costs of preparing your tax return.

Businesses that have a 31 March year end will be treated as having an accounting period that matches the tax year unless they elect out of this treatment. Therefore, the profits or losses of a 31 March 2027 accounting period would be treated as the profits or losses arising in the tax year 2026/27 and the profits from 1 April 2027–5 April 2027 would be deemed to be nil and included in 2027/28 tax year.

Impact of higher profits

As noted above there could be higher levels of profits being taxed for 2023/24 through to 2027/28. This could impact on the following areas:

- tapering of an individual's personal allowance
- the cap on income tax reliefs
- savings nil rate band
- limits on pension contributions
- higher NICs for these years

We would be happy to discuss these further and calculate what the possible impact could be for you.

FURTHER INFORMATION - if you are a sole trader or a 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.