SIMPLIFIED CASH BASIS FOR UNINCORPORATED PROPERTY BUSINESS

Response by the Association of Taxation Technicians

1. Introduction

1.1 The Association of Taxation Technicians (‘ATT’) is pleased to have the opportunity to respond to the consultation document *Simplified cash basis for unincorporated property businesses* (‘the Consultation’) which was published by HMRC on 15 August 2016.

1.2 The primary charitable objective of the ATT is to promote education and the study of tax administration and practice. We place a strong emphasis on the practicalities of the tax system. Our work in this area draws heavily on the experience of our members who assist thousands of businesses and individuals to comply with their taxation obligations. This response is written with that background.

1.3 As this is a Stage 2 consultation, our response assumes that the introduction of Making Tax Digital (‘MTD’) will proceed as set out in the separate consultation document *Making Tax Digital: Bringing business tax into the digital age* (‘the Main Document’). That assumption should not, however, be taken to imply that we agree with all the proposals within the MTD project. Briefly stated:

- We are very concerned about the proposed timescale for the implementation of MTD;
- We continue to question the benefit (for HMRC) and the practicality (for both customers and HMRC) of quarterly updates; and
- We are opposed in principle to the mandatory use of electronic record keeping and consider that the suggested exemption threshold of £10,000 is far too low.

---


1.4 In sections 2 to 4 below, we respond to the Consultation questions in Chapter order following the numbering of the questions.

2 Simplification proposed

2.1 Question 1: Do you feel there should be a relevant maximum limit imposed for eligibility for the cash basis for unincorporated property businesses? If so, what should this limit be and why?

2.1.1 We see no reason in principle why there should be a relevant maximum eligibility limit for the cash basis for unincorporated property businesses.

2.1.2 However, the Consultation gives no indication as to why there should be a distinction in this respect as between property businesses and trading businesses. We think that it would be helpful to have an explanation for the distinction. It is possible that such explanation might assist consideration of whether certain categories of trading businesses might similarly be exempted from the relevant maximum limit eligibility rule.

2.2 Question 2: Do you feel there is any reason why the cash basis should not be optional for all eligible unincorporated property businesses?

2.2.1 No.

2.3 Question 3: Would you want to opt in for each of their property businesses separately (for example, UK property business and overseas property business) or would they prefer to choose whether to opt in for all their property business income or none of it?

2.3.1 We see no reason why the option for cash basis should be on an all or nothing basis. We think that taxpayers should be able to opt separately in respect of their different property businesses.

2.3.2 Without such a separate option facility, we think that take up of the cash basis might be restricted - for example in the situation where joint owners of a property wished to opt for the cash basis but one or both of them also had a separate sole-name property which they wished to keep on the accruals basis.

2.3.3 The ability to be selective in opting would provide greater flexibility. That could be particularly useful in connection with an overseas property business as that might be subject to specific rules in the foreign jurisdiction.

2.4 Question 4: Does the above advice give you enough information to decide whether or not to use the cash basis with/without (please indicate) professional advice? If not, what else would you need to know about the new rules?

2.4.1 We think that those taxpayers with property businesses who regularly obtain professional tax advice in respect of their business would be likely to seek advice on the implications of opting for the cash basis.
2.4.2 For those taxpayers with property businesses who do not currently seek professional tax advice, we are doubtful whether the explanations contained in the Consultation would provide enough information to enable them to decide whether to opt for the cash basis. We would not expect many to appreciate fully the implications of opting for the cash basis.

2.4.3 Against the background of recent (and predominantly adverse) legislative changes that impact residential property businesses (the higher rates of SDLT and the higher rate of CGT – both from April 2016 – and the basic rate relief restriction on finance costs which is being phased in from April 2017), we think that taxpayers with residential property businesses may be instinctively cautious about the proposals. If HMRC wishes to encourage the use of the cash basis by property businesses, it may be appropriate for the department to work closely with bodies that specifically represent landlords.

2.4.4 We think that taxpayers with property businesses who were considering whether to opt for the cash basis might wish to have confidence that there was a commitment to the continuing availability both of the option itself and the ability to revoke the option and return to the accruals basis. (We appreciate of course that Parliamentary sovereignty prevents any formal guarantee.)

3 Proposed details of cash basis

3.1 Question 5: Does a regime that allows for individuals letting jointly, not in partnership, to separately opt to report using the cash basis present particular difficulties or issues?

3.1.1 It could increase compliance costs as there would need to be two separate calculations of taxable profit and it could be confusing for HMRC if two joint owners had different levels of profitability from the same property but the principle of allowing separate choices seems correct.

3.2 Question 6: Should eligibility for the trading income cash basis affect eligibility for the cash basis for unincorporated property businesses? If so, do you have any suggestions on what this interdependence should be?

3.2.1 We see no reason why there should be any interdependence of eligibility for the cash basis as between a taxpayer’s trading and property businesses. This is consistent with our comment in 2.3.1 above concerning a taxpayer’s ability to opt in relation to separate property businesses.

3.3 Question 7: Would only recognising deposits that landlords are entitled to keep at the end of a tenancy create unnecessary complexity?

3.3.1 We can see no reason why it should. The receipt of the deposit is not logically part of the business income at that time. If and when it does become part of the business income, there is likely to be an allowable business expense of very much the same amount. There is no justification for premature recognition as income something which at the time of receipt has a wholly distinct character.
3.3.2 We think, however, that it could be helpful if HMRC built a reminder about the repayment or crystallisation of deposits into the MTD reporting system.

3.4 **Question 8: Do you feel there is anything which has not been considered which could make the cash basis as simple as possible for landlords?**

3.4.1 We think that clarification is required on the tax treatment of expenditure on certain items which might not otherwise be thought to be deductible for tax purposes.

Section 2.19 of the Consultation states:

“For those with residential properties that do not qualify as a furnished holiday let (FHL), relief for domestic items, such as furniture, household appliances and kitchenware would be available on only the cost of replacing these items. In line with the rules being introduced from April 2016 for all residential landlords, (see Reform of Wear and Tear Allowance, published on 9 December 2015) no relief would be available on the initial cost. No other relief would be available for capital expenditure on assets provided for the tenants of these properties. FHLs would continue to be able to claim the initial cost, as well as any replacement costs, for plant and machinery eligible for capital allowances.”

3.4.2 When what has become s.72, Finance Act 2016 was introduced at Finance Bill stage (where it was clause 68), we asked the HMRC relevant specialist whether, in the context of a trading businesses, the repeal of s.68 ITTOIA 2005 would mean that businesses would be obliged to claim capital allowances in respect of expenditure on items of limited life expectancy. We gave the example of a carpenter’s expenditure on saws. The helpful reply that we received from the HMRC specialist was that expenditure on such items would normally qualify as revenue (not capital) expenditure under GAAP principles and that they would not expect HMRC to challenge the writing-off as consumables of any expenditure on items of relatively modest cost which had a useful life expectancy in the context of the particular trade of less than two years.

3.4.3 The advice from HMRC in connection with the repeal of s.68 ITTOIA 2005 (referred to in 3.4.2 above) prompts two questions in the context of the simplified cash basis for unincorporated property businesses:

- Does the deductibility of expenditure under GAAP on items with a life expectancy of less than two years apply equally to property businesses?

- Does opting for the cash basis negate the deductibility?

3.4.4 Where a property business is preparing its accounts in accordance with GAAP, we think that it is clear that the taxation treatment of expenditure on items which meet what HMRC refer to as the **two-year test** should be exactly the same as for a trading business. S.272(1) ITTOIA 2005 requires the profits of a property business to be calculated in the same way as the profits of a trade and s.272(2) specifically recognises the application of s.25 of the same Act which requires the calculation of profit to be in accordance with GAAP. Ignoring for the moment any question of opting for the cash basis, that means that a taxpayer with a property business can properly deduct expenditure on items with a life expectancy of less than two years without having to consider whether for tax purposes they might have a capital character. That, as we understand it, is the case
whether or not the expenditure was on a replacement; initial expenditure on relevant items is equally deductible.

3.4.5 Turning to the second question in 3.4.3 above, we do not read section 2.19 of the Consultation (quoted in 3.4.1 above) as intending to disapply GAAP. We do, however, think that it requires amendment to recognise that expenditure (including initial expenditure) on domestic items, such as furniture, household appliances and kitchenware may be deductible for tax purposes (whether or not there is an option for the cash basis) in accordance with GAAP. The key point appears to be that GAAP is followed in determining whether such expenditure has a capital character.

3.4.6 We think that clarification on the tax treatment of expenditure on items with a life expectancy of less than two years could be helpful in the context of opting for the cash basis.

3.4.7 For completeness, we mention that section 3.29 of the Consultation refers to the same restrictions on the deductibility of capital expenditure.

3.5 Question 9: Are you aware of any risks that the cash basis for unincorporated property business could present which could lead to the avoidance or reduction of liability to income tax? If so, please provide detail.

3.5.1 We have not identified such risk in the course of preparing this response.

3.6 Question 10: Do you have any comments, not already provided, on any aspect of the proposal?

3.6.1 No thank you.

4 Assessment of impacts

4.1 Question 11: If the government introduces a simpler tax system for unincorporated property businesses, please provide details of how this will affect your business. This should include details of both the expected one-off and ongoing benefits and costs of:

   a) Familiarisation with the new basis and updating your software or systems
   b) Not having to keep accruals accounts and prepare calculations in accordance with UK GAAP.

4.1.1 We are not in a position to respond to this question.

4.2 Question 12: Please tell us if you think there are any other benefits or costs not covered in the summary of impacts below.

4.2.1 We are not in a position to respond to this question.
5 Contact details

5.1 We would be pleased to join in any discussion related to this Consultation. Should you wish to discuss any aspect of this response, please contact our relevant Technical Officer, Will Silsby, on 01905 612098 or at: wsilsby@att.org.uk.

Yours sincerely

Yvette Nunn
Co-Chair of ATT Technical Steering Group

6 Note

6.1 The Association is a charity and the leading professional body for those providing UK tax compliance services. Our primary charitable objective is to promote education and the study of tax administration and practice. One of our key aims is to provide an appropriate qualification for individuals who undertake tax compliance work. Drawing on our members' practical experience and knowledge, we contribute to consultations on the development of the UK tax system and seek to ensure that, for the general public, it is workable and as fair as possible.

Our members are qualified by examination and practical experience. They commit to the highest standards of professional conduct and ensure that their tax knowledge is constantly kept up to date. Members may be found in private practice, commerce and industry, government and academia.

The Association has over 8,000 members and Fellows together with over 5,700 students. Members and Fellows use the practising title of 'Taxation Technician' or 'Taxation Technician (Fellow)' and the designatory letters 'ATT' and 'ATT (Fellow)' respectively.