

Expanding the cash basis for the self-employed: CIOT, ATT and LITRG responses

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The CIOT, LITRG and ATT responded to an HMRC consultation on proposals to increase eligibility and use of the income tax cash basis scheme for the self-employed. The proposals aim to increase the number of businesses eligible to use the regime and make the rules easier to apply and understand.

The cash basis was introduced in 2013. It allows unincorporated businesses to calculate their taxable profit as the difference between income and expenditure when money is received or paid out, rather than in accordance with generally accepted accounting practice (GAAP accounting), provided certain criteria are satisfied. The consultation document identified a number of potential areas to simplify and expand the regime:

- reviewing the turnover threshold for the cash basis to expand the regime to larger unincorporated businesses;
- setting the cash basis to the default basis for eligible businesses to calculate taxable profits;
- relaxing the interest restriction for businesses in the cash basis to widen access to businesses that have interest costs above £500 per year; and
- removing the restrictions on loss relief in the cash basis to allow new businesses to use the cash basis while setting loss relief against other sources of income.

CIOT response

In our response, the CIOT agrees that it is an appropriate time to review the regime now that it is 10 years old. Despite the cash basis not being introduced in exactly the way that the Office of Tax Simplification recommended in its 2012 report, it does provide some simplification for those businesses that have chosen to use it. However, there are aspects of the current rules that can deter otherwise eligible businesses from using the cash basis.

We would like to see the current restrictions on loss relief and finance costs relaxed. In our view, these are the most significant barriers to use of the cash basis. There seems to us to be little evidence of avoidance to justify them. The current restrictions undoubtedly influence a business's decision not to join the cash basis. We also think that increasing or removing the entry and exit thresholds should not be done without also addressing the loss relief and finance cost restrictions.

Similarly, the cash basis should not be made the default without addressing these restrictions too. More generally, we are concerned that HMRC are proposing making the cash basis the default without investigating and thereby fully understanding why eligible businesses are not currently using it. We think it is likely that there is a significant lack of understanding and awareness of the cash basis, particularly amongst unrepresented businesses. Making the cash basis the default could lead to businesses using it 'by accident', even though the accruals basis may be more suitable for their needs.

We note that the guidance for the cash basis on [GOV.UK](https://www.gov.uk) needs improving and updating and suggest that it should be included in the Small Business Guidance Transformation Project which was announced by the Chancellor in the March 2023 Budget (see paragraph 4.92 of the ‘Red Book’). If guidance is improved, this may help to increase understanding and awareness and lead to more businesses taking advantage of the simplifications offered by using the cash basis, where it is appropriate for them to do so.

Ultimately, the cash basis, even an expanded and less restrictive version, is still likely to be suitable only for small businesses with very straightforward financial affairs; in other words, unrepresented taxpayers with no employees and without, or with very low, levels of stock, debtors, creditors and fixed assets. Our impression is that the cash basis is not widely used by taxpayers represented by an agent. This is because preparing accounts on a cash basis really only satisfies the need to report to HMRC, whereas reporting on an accruals basis will serve several purposes, including accurately measuring profitability and performance and providing evidence for loan applications.

The CIOT’s response can be found at: www.tax.org.uk/ref1107

ATT response

The ATT consider that there is limited merit in significantly increasing or removing the cash basis entry and exit thresholds. There are many reasons beyond tax why a business may choose the accruals basis, and the cash basis is simply not suitable for many larger businesses.

If the cash basis is made the default, we believe this should be accompanied by relaxation of the current interest and loss restrictions. An extensive education campaign would also be required to ensure that taxpayers are aware of the change and apply the cash basis correctly.

Overall, we feel that the current interest deduction limit under the cash basis of £500 is too low and should be increased significantly. Sideways loss relief should also be allowed for cash basis losses, subject to the general reliefs cap in ITA 2007 s 24A.

The ATT’s response can be found at: www.att.org.uk/ref419

LITRG response

LITRG broadly support the expansion of the cash basis. A default cash basis will not make more unincorporated businesses eligible to use the scheme; however, increasing the interest restriction threshold (providing it was sufficiently uprated) and relaxing loss relief restrictions may increase take-up of the cash basis.

In LITRG’s experience, many low-income unrepresented businesses do not understand or give much consideration to the basis on which they work out their accounts for tax purposes and are often unaware that there is a choice of two different methods. This means that there are likely to be businesses using the cash basis without ticking the box on their tax return confirming that they are doing so. By making the cash basis the default option, we consider it would formalise what is happening for many unrepresented businesses.

We strongly recommend that HMRC improve their general communications and guidance on the cash basis, especially in growing sectors of self-employment, such as those trading through online platforms. This improvement in guidance should be a priority even if these proposed changes do not proceed.

There are differences between the cash basis for tax and cash accounting for Universal Credit, and the proposals for interest and losses could increase these disparities. However, we think there could be an opportunity for

greater procedural alignment in the reporting processes for Universal Credit and for tax purposes under self-assessment and potentially under MTD for Income Tax.

We consider the timing of introducing any change to the default basis is important. In particular, if the default was changed to the cash basis it would be helpful if it does not coincide with other significant changes for the self-employed such as basis period reform in the 2024/25 tax year or the start of the roll-out of MTD in the 2026/27 tax year.

The LITRG response can be found at: www.litr.org.uk/ref2769

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