Think Ahead ACCA

Simplified cash basis for unincorporated property businesses

A public consultation issued by HM Revenue and Customs

Comments from ACCA to HMRC
November 2016
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The expertise of our senior members and in-house technical experts allows ACCA to provide informed opinion on a range of financial, regulatory, public sector and business areas, including: taxation (business and personal); small business; pensions; education; and corporate governance and corporate social responsibility. www.accaglobal.com

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ACCA welcomes the opportunity to comment on the proposals issued by HMRC. The ACCA Global Forum for Taxation and UK Tax Committee have considered the matters raised and a large number of ACCA Members and businesses have contacted us with their comments. Their views are represented in the following. This response should be read in conjunction with the comments made on the HMRC MTD consultation suite..

GENERAL COMMENTS

The proposals for Making Tax Digital ("MTD") and the associated £1.3bn investment in HMRC systems changes are the most significant tax project of recent years, and probably the single government project with the widest and deepest short to medium term impact on the population in general. There are three principle aspects to the tax system – the legislation that imposes the charge, the forms and mechanisms that enable assessment and communication of the charge, and finally the payment processes that facilitate collection of the charge – and MTD for business will affect all three.

ACCA has engaged with HM Treasury and HMRC from an early stage on the Making Tax Digital proposals, and we have significant concerns that the transition to quarterly reporting, and potentially payment, of taxes will create difficulties for many sectors, transactions and tax rules.

While this consultation is not directly a part of the MTD programme, and the measures contained in it could be implemented entirely independently of MTD, there will be an inevitable interaction between them. Where specific benefits can accrue from such interaction we have attempted to identify them, and likewise to warn of potential risks which may arise.

The proposals to introduce cash accounting for landlords present comparatively few technical issues, and would seem unlikely to create particular difficulties or significant additional costs for professionally advised taxpayers. However, the retention of the £500 interest and finance costs limit, especially combined with other regulatory requirements impacting property businesses around the UK, seem likely to severely restrict the practical attractiveness of the proposed scheme to a large number of otherwise potential adopters.

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AREAS FOR SPECIFIC COMMENT:

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

There are various competing sets of priorities at play. On the one hand, simplification of the tax system would dictate no upper limit, with businesses free to make their own choice based upon their business needs. However, at higher income levels, the tax potentially at stake increases, and the distinctions in treatment of certain items will potentially open up more significant opportunities for tax arbitrage. There is also the aspect that sole traders are not subject to the same transparency and accountability requirements as incorporated businesses, and landlords in particular as a sector are in a position of trust where their activities potentially have a more significant impact upon society and its members than many other businesses.

This final point however highlights that tax is rarely the most important aspect in any business decision, or in the framework of obligations that society places around any particular activity. In many parts of the country, Under the selective licensing scheme for landlords, it can be an offence for an unlicensed landlord to be involved in the management of rental properties in many parts of the country. Accordingly, the day to day operation of, and accounting for, rental properties, is typically delegated to agents with the owners regarding them simply as an investment. As a consequence, choice of accounting method may be dictated as much by the preference of the agent as of the owner.

If the cash basis is to be available for unincorporated landlords then it should be potentially available at all income levels. There are a significant number of other practical considerations which will restrict its availability and attractiveness, so there is no need to further complicate it with unnecessary conditions.

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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?

It seems likely that taxpayers will benefit from that flexibility. The retention of the £500 maximum limit on interest/finance costs, in addition to the other restrictions on rates of relief for interest in property businesses, will incentivise landlords to opt for accruals accounting in respect of any individual property against which they hold borrowings, while potential preferring to retain the cash basis for any other properties owned.

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?

Feedback from our Members indicates that in most cases taxpayers will take “cash basis” to its logical literal extreme, and the complexities around “renewals only” for furniture and equipment deductibility and the conditions relating to interest relief mean that without professional advice there is a significant risk of taxpayer error. HMRC should ensure that any expansion of the cash basis to property businesses is accompanied with a widespread and effective communications campaign to highlight to landlords that although the cash basis is a more simple way to account for tax, it does not remove the need for all tax adjustments.

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?

In theory the timing of reporting, and adjustment of apportioned figures, should not present any particular difficulties. However, in practice most joint owners operate from a single bank account, and it seems unlikely that the interests of the owners would be so divergent as to justify analysing the information twice so as to prepare two sets of figures. Likewise where a paid agent manages the property business it seems unlikely that the tax benefits to the owners would outweigh the additional administrative costs of paying for two sets of business tax accounts.

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**Question 6 Should eligibility for the trading 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?**

There is no current interdependence, and it is not clear what benefits might accrue from the additional complexity that any such condition would require.

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

It would create additional complexity. Whether that is unnecessary or not depends upon the balance intended to be struck between simplicity and comparability to existing tax regimes. The interest restriction and renewals basis conditions also introduce additional complexity, but which HMRC clearly consider to be necessary.

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?

As indicated elsewhere in this response, there are elements to the cash basis for landlords which pose a risk of error and confusion. Removal of those required adjustments could make the cash basis simpler for landlords.

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 details.

It is not immediately apparent how the proposals might enable avoidance or reduction of liability to income tax other than as intended under the new model. However, there is a clear risk that taxpayers will fail to operate the conditions and restrictions under the simplified model correctly, resulting in potential timing errors or under-declarations which could have a negative Exchequer impact.

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

Given the relative simplicity of most property businesses, the need for full GAAP accounts for management accounting forecasts is likely to be less than for trading businesses. Likewise, most finance will be raised specifically for new additions to the portfolio rather than against existing assets, so GAAP accounts for finance providers are less typically a requirement. However, the retention of the £500 finance limit will effectively rule out the cash basis in respect of any property business with more than trivial levels of borrowing outstanding.

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.

Evidence from Members suggest that the main cost would be in explaining the detail of any changes to clients. Professional accountants typically operate systems which will be well able to cope with either cash basis or accruals accounting, and likewise staff will need comparatively little training to accommodate the new regime. Typically taxpayers ask for an explanation and calculation on which choice will be beneficial. One area which could add cost is the requirement to track the £500 finance cost limit in addition to the other restrictions which already have equivalents in existing processes.

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

The main MTD cost likely to impact property businesses is unlikely to be the availability or otherwise of the cash basis, but the switch to quarterly accounting on a property by property basis. Members have indicated costs for their practice in excess of £100,000

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(regional practice with several thousand clients in total) to manage the switch to quarterly reporting for landlords.

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