

**Simplifying tax for unincorporated businesses  
HM Revenue & Customs (HMRC) consultation document  
Response from the Low Incomes Tax Reform Group (LITRG)**

## **1 Introduction**

- 1.1 LITRG welcomes the opportunity to comment on all the Making Tax Digital (MTD) consultations issued on 15 August 2016. In addition to answering specific questions, our response includes general comments on the four areas the consultation discusses; the cash basis, basis periods, simplified reporting and capital and revenue expenditure.
- 1.2 This consultation response should be read in conjunction with our responses to the other consultations on MTD.
- 1.3 We begin though with some general comments on the MTD policy.

## **2 Making Tax Digital programme**

- 2.1 We generally support the HMRC digital strategy and recognise that many benefits may be possible in the digital world. We are though hugely concerned that much of the detail of the MTD programme is still to be considered and finalised, and as a result implementation of MTD for unincorporated businesses from April 2018 is totally unrealistic and unachievable in the timescale.
- 2.2 The current timetable does not allow sufficient time for:
- HMRC to properly publicise and educate the public about MTD;
  - businesses to prepare for these very significant changes, both in terms of practical impacts and the additional costs which will result;

- the software – which is crucial to the success of MTD – to be anything like fully developed and tested.

- 2.3 We strongly urge HMRC to delay the commencement of MTD until the design has been completed and fully tested. This should substantially reduce the massive risk of the project going seriously wrong with the damage done to HMRC reputation but also the inevitable ‘teething problems’ that will without doubt occur. A more relaxed introduction will therefore lessen the chances of the public quickly losing faith in the system, reduce the chance of naturally compliant taxpayers making mistakes due to having to rush into unfamiliar territory, and protect HMRC from reputational damage.
- 2.4 We do not support the principle of mandating MTD and are wholly opposed to this approach. If we compare it to self assessment (SA) online filing which has been very successful without being mandatory, we can see that if a product is good and beneficial, taxpayers will naturally migrate to it. Mandation is very likely to have the opposite effect to that which it is intended to foster: instead of increasing tax receipts, it may act as a disincentive to businesses to trade legitimately and encourage some into the hidden economy.
- 2.5 Many businesses with low incomes will find it extremely difficult to comply with the requirements of MTD for a number of reasons, being cost, extra administrative time, lack of IT knowledge, and lack of financial literacy. To make the system work as smoothly as possible, we would strongly recommend that the exemption level is raised very substantially above the proposed limit of £10,000 annual turnover. In our view we consider that the exemption limit should initially be set at an amount equivalent to the current VAT registration threshold. This should at least mean that MTD for business will be more successful from the outset as potentially problematic traders will be below the exemption limit. In turn, fewer resources will be required to provide digital and perhaps financial support to those who will need assistance. This should result in a much smaller group than would otherwise be the case. But if MTD is as good as HMRC promise, traders will almost certainly wish to join it voluntarily.
- 2.6 The success of the MTD programme depends heavily on the use of good software. It is the responsibility of Government to provide free software where it is a requirement to have software to be able to comply with legal obligations. In respect of MTD HMRC should ideally provide good, free software to small businesses. Relying on commercial businesses to make free software available is, in our view, fraught with very significant problems and is wholly unsatisfactory. Free software provided from commercial sources will have only limited functionality, thus those unable to afford upgraded packages could be excluded from many of the purported benefits of MTD and free software providers will constantly be bombarding their customers with update requests.
- 2.7 Finally, there will always be some taxpayers who are digitally excluded for a variety of reasons such as lack of broadband due to remote location, or age, or disability. The service and support available to this group of taxpayers must be of at least the same level as that available to digitally enabled taxpayers. Regretfully, the detail of what this support will likely be has not yet been made clear.

### **3 Executive Summary**

- 3.1 LITRG has very serious concerns about the significant number of changes being proposed within the 'simplifying tax for unincorporated businesses' consultation. Small businesses will be expected to know a huge amount of detail to understand how these changes to the tax and accounting systems could affect their tax position. This is totally unrealistic and worrying, especially given the tight time scales for implementation. There are major changes proposed to the accounting periods, the methods of preparing accounts and how capital and revenue expenditure are classified and reported. We continue to be very concerned that the current timescale to launch MTD will not provide sufficient time for HMRC to consider these material changes in enough detail, write guidance and publicise the choices businesses will need to make; this lack of planning time could undermine the transition to digital reporting and is a major risk to HMRC.
- 3.2 If any of these proposed simplifications are implemented, then crucially they should not be at the same time as the MTD regime is introduced. If all the changes happen at once, there will be too much for taxpayers to cope with in the transition period and significant errors will almost inevitably be made. There is also the risk that taxpayers will find all the changes so overwhelming they will cease to engage with HMRC altogether.
- 3.3 We strongly recommend that the balance of flexibility versus complexity be reconsidered. HMRC are proposing to design a system which is flexible to help small businesses with their new reporting requirements, but which introduces significant complexity to achieve this. This will result in businesses having to make a number of key decisions which will affect their tax affairs, such as what accounting basis and what accounting periods to use. We are concerned that small unrepresented businesses will not have the appropriate understanding to make the best decisions and this could result in them being at an unfair tax disadvantage when compared to businesses who are well able to afford professional advice. The complexity could result in taxpayers doing nothing. We recommend that software contains nudges and prompts explaining the different tax consequences when making decisions on basis periods and choosing which accounting basis to use.
- 3.4 We strongly recommend that HMRC work alongside the Department for Work and Pensions (DWP) to reduce the administrative time and costs for universal credit (UC) claimants. The system as currently proposed could result in self-employed UC claimants having to prepare different monthly reports for both DWP and HMRC; this must be resolved by fully aligning the cash accounting rules and reporting systems for tax and UC. Until this is done, and until systems are aligned such that a single report for UC and MTD is sufficient, we believe UC claimants should be exempt from complying with MTD altogether. This is discussed further in the section on exemptions in our response to the consultation document 'Making Tax Digital: Bringing business into the digital age'. HMRC also need to consider how self-employed tax credit claimants will be affected by these proposals. The consultation does not mention how they will be affected by these changes, however under the current UC rollout timetable there will still be tax credits claimants in 2022.

- 3.5 We recommend that the cash basis entry threshold remains aligned to the VAT registration threshold.
- 3.6 We recommend that HMRC consider allowing businesses with existing overlap relief to be able to utilise this relief upon the introduction of quarterly digital reporting. This may help to pave the way for a 'voluntary pay as you go' system (as discussed in the separate consultation) by reducing the impact of a 'catch up' period to move from the existing format of tax payments under SA to a model of 'real time' tax payments based on quarterly-reported data and consequent estimates of tax due.
- 3.7 We further recommend that the 'simpler reporting' accounting is not introduced for the time being as this will be a further complexity for unrepresented businesses. Such businesses will need to decide whether to implement the changes and we consider this complicated accounting approach will result in more errors being made by small businesses. Instead of introducing an additional option, we would encourage HMRC to use their resources to promote a better comprehension of the existing accounting methods – the cash basis and the accruals basis.

#### **4 About Us**

- 4.1 The LITRG is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.
- 4.2 LITRG works extensively with HMRC and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.
- 4.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

#### **5 Increasing the trading cash basis entry threshold**

##### **5.1 *General comments***

- 5.1.1 We note the potential expansion of the cash basis is being considered as there is an understanding that this will make complying with the new digital record keeping and reporting requirements explained in the consultation document 'Making tax digital: bringing business into the digital age' more straightforward. We agree that for some small businesses

the cash basis approach does simplify the business records they need to keep. However, as the consultation recognises, it is not appropriate for all businesses, so the voluntary option to elect to use the cash basis must be continued and guidance must also be written for businesses which use the accruals basis in preference to the cash basis. It would be wrong and unfair if a business is effectively forced to change its accounting basis at the risk of being non-compliant if they do not – for example because the digital tax reporting systems or ‘apps’ do not support the accruals basis to the same extent as the cash basis.

5.1.2 If it is decided to encourage more businesses to use the cash basis, whether by increasing the entry threshold or promoting it as part of the digital tax reporting regime, then we recommend that the limited guidance currently available on GOV.UK<sup>1</sup> be substantially improved. Free software must provide sufficient nudges and prompts to enable unrepresented taxpayers to understand the full implications of using the different accounting bases. Unrepresented businesses need detailed and practical advice; they also need to fully understand the consequences of choosing to use the cash basis. An example of where better guidance is required in respect of the cash basis is the date on which to record a transaction; is it when the business is presented with a cheque, or deposits the cheque in their bank, when the bank processes the cheque or when the cheque clears?

5.1.3 We recommend HMRC dedicate resources to publicising the cash basis better to encourage more small businesses to consider applying this basis, if it would be beneficial.

5.1.4 The consultation does not address when the business will need to make a final decision on which accounting basis to use. The current system allows the taxpayer to elect to use the cash basis as part of their SA tax return, so after the tax year has ended. We recommend that the final decision is made as part of the End Of Year (EoY) report as only at this time will the taxpayer have sufficient information to know which accounting basis would be most appropriate for them to use.

5.2 ***Question 1a: What level do you consider to be an appropriate turnover entry threshold?***

5.2.1 In order to fully consider a response to this question it would have been useful if the consultation had provided a breakdown of the turnover levels of the one million businesses currently using the cash basis and also whether any of these were UC claimants. If this information had been provided we would have been able to appreciate whether the cash basis is being used by businesses with low turnover (say under £60,000) or by businesses nearing the entry (and exit) thresholds so there is a clearer justification of the proposal to increase it.

5.2.2 It is worth noting that UC claimants are required to report their income from self-employment to the DWP regardless of whether their turnover is below the cash basis entry threshold.

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<sup>1</sup> <https://www.gov.uk/simpler-income-tax-cash-basis>

- 5.2.3 We agree with the consultation that there should be an entry threshold in place and that the cash basis simplified accounts would be inappropriate for larger businesses or businesses which need more detailed accounts for other reasons than reporting to HMRC, such as a requirement for banking facilities, or required by external shareholders.
- 5.2.4 The VAT registration threshold seems to have been a good initial choice for the entry threshold to use the cash basis. Although businesses can voluntarily register for VAT with a turnover below the registration threshold, it is a reasonable indicator of when a business's accounts would become more complex and therefore the cash basis may be deemed less suitable than the accruals basis.
- 5.2.5 With the proposed introduction of digital quarterly reporting it would seem an appropriate time to reconsider the entry threshold and also consider how to make the reporting process easiest for small businesses. We recommend that the entry threshold remains the same as the VAT registration threshold. In addition, if the cash basis and VAT registration thresholds are the same, there is one less threshold for businesses to remember and bear in mind. The only other observation we would make, in passing, is that decoupling from the VAT threshold may be necessary in the event that 'Brexit' means that substantial changes are made to the VAT system.
- 5.3 ***Question 1b: For a threshold not linked to the VAT threshold, should it be reviewed annually in the light of inflation or less frequently (please state recommended interval)?***
- 5.3.1 The MTD consultations propose wide-ranging significant changes to the current reporting of income and expenses for tax purposes; because of this we recommend that any thresholds are adjusted each year for inflation and that such indexation should be provided for in statute.
- 5.4 ***Question 2a: If the entry threshold were to be increased, do you agree that the exit threshold should continue to be set at twice the entry threshold?***
- 5.4.1 We agree that the exit threshold should continue to be set at twice the entry threshold. Businesses will need as much consistency as possible when they change to a new method of reporting their tax information. It would be helpful if there is a large gap between the entry and exit thresholds to enable businesses with sales over the entry threshold a period of stability before they have to consider changing their accounting basis.
- 5.4.2 It may be the case that if a high exit threshold is implemented, say four times the VAT threshold (currently equating to £332,000), that the cash basis is no longer appropriate for some businesses because more detailed financial accounts are required for banking or shareholder purposes. Therefore, we recommend that the commercial reasons HMRC accept in order to change from the cash basis to the accruals basis should include the requirement for more detailed financial accounts.
- 5.5 ***Question 2b: If the entry threshold were to be increased, do you agree that the UC threshold should continue to be set at twice the entry threshold?***

- 5.5.1 It would be helpful if HMRC could explain their reasoning behind the automatic doubling of the entry threshold when compared with non-UC claimants. We understand that it is useful for UC claimants under the current cash basis threshold but depending on what revised entry threshold is chosen, there is a significant difference between the doubling of the current threshold of £83,000 and the doubling of the proposed threshold of £166,000.
- 5.5.2 The argument for the proposed increase to the cash basis entry threshold is to allow more small businesses to use the cash basis if they consider it would make reporting under MTD easier and less administratively burdensome. It is reassuring that HMRC want to encourage as many UC claimants to use the cash basis as possible, as UC claimants will also have to prepare monthly reports for DWP in addition to at least quarterly reporting for tax purposes, (but see our further comments at 6.3.2 below on this point). However, we recommend that HMRC and the DWP consider whether there is a need for a separate entry threshold for UC claimants, for example if the revised entry threshold of £166,000 is chosen, a UC claimant would then need a turnover of £322,000 to leave, which seems to be far above and beyond what would be necessary. Alternatively, a simpler approach would be to allow all UC claimants to opt to use the cash basis if they wish to, rather than having to consider different entry and exit thresholds (though provision would then need to be made as to what happens if that person ceases to be entitled to UC).

## **6 Reforming the basis periods**

### **6.1 *General comments***

- 6.1.1 The proposal to reform the basis periods is a fundamental change to the current tax system. It would seem to be questionable as to whether it is in fact simplification as the proposed changes are potentially very complex in many cases. For those businesses struggling to get to grips with the whole MTD programme this may well be one step too far for them. It is absolutely vital that proper guidance is available for small businesses explaining the new rules if it is decided to implement this change.
- 6.1.2 Businesses which have accrued overlap relief need to be informed about any changes to how they can obtain relief. Often HMRC guidance on the GOV.UK website over-simplifies complex situations to the detriment of the unrepresented taxpayer; we are concerned that if the same approach is taken then some self-employed taxpayers could lose their overlap tax relief as they would not understand the changes and the additional profits on which they have previously paid tax may be forgotten upon the cessation of their trade. In view of this, it would be helpful if the overlap relief position was included as part of the digital tax account so that it is not mistakenly forgotten about upon the cessation of the business.
- 6.1.3 It seems unfair that businesses who currently have overlap relief will not be entitled to use it if they change their accounting period under MTD. For these businesses it would be helpful if they were given the opportunity to use any overlap relief upon the move to quarterly reporting. This could provide an advantage of reducing the number of businesses who have

accrued overlap relief who then need to consider utilising it upon the cessation of their trade and so would simplify their tax position going forward. It may also discourage any false 'cessations of trade', as some businesses may try to utilise their overlap relief before the new rules restrict them. If relief for overlap profits is not provided during the transition to MTD, taxpayers and HMRC will be dealing with overlap profits for many years to come. They may also struggle to move to a more 'real time' payment model for their tax, as HMRC clearly hope to encourage according to the separate consultation on 'voluntary pay as you go' as doing so would inevitably involve some double payment of tax. Allowing overlap relief on the transition could assist with this.

- 6.1.4 There needs to be a balance between complexity and flexibility. While we agree that the current rules and the calculation of overlap relief can be complex to understand, we are extremely concerned that the proposals to permit individual flexible accounting periods (which could range from monthly, six-weekly and quarterly as per the examples in section 3 of the consultation) will result in additional confusion for the self-employed who are unable to afford professional tax advice. This lack of understanding of the rules and their implications on an individual's tax position could result in poor decisions, or even no decisions being made and a possible withdrawal of interaction with HMRC by taxpayers who are overwhelmed by a more complicated system. There is a risk that if an unrepresented taxpayer misunderstands what an accounting period is and ends their accounting period each time they submit a quarterly update they may be required to complete more EoY declarations. It would be helpful if there are proposals for default accounting periods to help unrepresented taxpayers, for example, a default quarterly position ending on the accounting year-end or a default monthly position for UC claimants using the DWP monthly reporting deadlines (however see paragraph 6.3.2 regarding the importance of the complete alignment of the different cash accounting rules for UC and tax purposes).
- 6.1.5 The consultation does not consider how these proposed changes will affect tax credit claimants. Under the current UC rollout timetable there will still be tax credit claimants in 2022, after the proposed introduction of digital tax reporting. An EoY reconciliation is crucial for tax credit claimants so a detailed understanding of how this will work with any changes of accounting periods is required by both HMRC and self-employed claimants who are considering changing their accounting period dates. The amount of tax credits awarded is initially based on the previous year's income so it is important that consideration is given to transitional rules if a self-employed claimant changes their accounting basis or accounting periods; this situation will be complicated further if it is a joint claim using different accounting periods.
- 6.1.6 Additionally, the consultation does not mention how the repayment of student loans through the tax system will be affected by changing the accounting basis period. Self-employed loan borrowers will need to understand whether their repayment threshold will be proportionately reduced if they have shorter accounting periods or whether the Student Loan Company will calculate their repayments over 12 months. This could add another consideration for taxpayers when deciding what accounting periods to use.



**6.2 Question 3: Do you agree with the proposed approach of following accounting periods? If not, what alternative approach would you support?**

- 6.2.1 While some taxpayers may want and find the flexibility of following accounting periods beneficial, it is important that self-employed taxpayers understand that they are likely to be required to have annual accounts for other purposes, such as mortgage applications. It may be the case that the taxpayer realises they need annual accounts after reporting multiple accounting periods and this could then cause an additional administrative burden. It would be useful to have confirmation from HMRC that this possible problem has been discussed with representatives from the banking industry.
- 6.2.2 The consultation does not provide detail on when a self-employed taxpayer would need to decide when their accounting periods will end. It may be clear to Bernadette and David (examples used in the consultation) as they have established businesses and have the experience to know what accounting periods would be most appropriate to their circumstances. It may be harder for a new business to decide what will work best for them, in which case it would be helpful to have a reasonable period of time before they have to commit to when future accounting periods will end.
- 6.2.3 We are concerned that HMRC expect that low-income unrepresented businesses, who cannot afford professional tax advice, will understand the importance of deciding when an accounting period should end. This is especially relevant towards the end of a tax year. For example, if a self-employed gardener has taxable profits of £11,000 up to the end of February but anticipates making profits of £3,000 in March, it might be better for him to choose to end his accounting period at 28 February and then have a new accounting period ending on 31 May, which will fall into the next tax year.
- 6.2.4 There is a risk that the flexibility of choosing basis periods could result in numerous comparison calculations when deciding what accounting period end to use. This would go against any idea of simplification and could result in taxpayers becoming confused with the tax reporting system and making a poor decision which could result in not fully utilising tax reliefs such as the personal allowance or marriage allowance. The latter may 'only' be worth £220 based on 2016/17 rates, but this amount may be vital to a low-income family.
- 6.3 Question 4a: Are there any other events or situations which would require additional rules?**
- 6.3.1 We are pleased to see the example of Judith, a UC claimant, included in the consultation. We are concerned that self-employed UC claimants will face significantly more administration when reporting their profits to both DWP and HMRC than other taxpayers. We anticipate that UC claimants are more likely to be unable to afford professional advice and therefore take on the reporting burden without any help.
- 6.3.2 We agree that it would be helpful for UC claimants to be able to align their reporting to HMRC with their monthly reporting requirements to DWP. However there is still a potential problem, since the cash accounting rules are not exactly the same for tax and UC purposes. Until this issue is addressed and the two cash reporting systems are fully aligned, depending

on the individual's business, there could be differences in the information being reported to HMRC and DWP and the UC claimant could have to prepare two separate accounts each month, which would be wholly unsatisfactory and unfair. We strongly recommend that this matter is addressed as soon as possible in order to reduce the administrative burden and potential reporting errors as UC claimants may get confused between the different rules, different jargon and explanations and using different IT systems. Until the two systems are fully aligned, and until such time as a single reporting obligation can satisfy both HMRC and DWP requirements, we believe UC claimants should be exempt from complying with MTD. This is discussed further in the section on exemptions in our response to the consultation document 'Making Tax Digital: Bringing business into the digital age'.

6.3.3 As explained at paragraph 6.1.3, we recommend that HMRC consider allowing businesses with existing overlap relief to utilise this relief upon the introduction of quarterly digital reporting; especially as some businesses may choose to change their accounting period and might have been able to utilise some overlap relief under the existing rules.

6.3.4 There is no mention of how the introduction of flexible accounting periods will affect Class 4 National Insurance contributions (NIC) and whether the NIC threshold would be applied to profits earned over the whole tax year rather than individual accounting periods.

6.4 ***Question 4b: Would it be helpful to make any changes to tax accounting periods for any other types of income?***

6.4.1 There could be situations where a taxpayer has more than one self-employed business and these have different accounting period ends, which may be difficult to align. This could make calculating tax payments more problematic, especially if one business is profitable and one is loss-making; if tax has been overpaid there should be a process in place which accelerates a tax refund when the loss-making business makes its reports.

## **7 Simplified reporting**

### **7.1 General comments**

7.1.1 We would like to understand why HMRC consider there is a need to introduce an additional alternative accounting system, as – far from being a simplification – this adds further complexity. If it is because they are concerned too few businesses will use the cash basis (whether by choice or because they fail to meet the entry requirements) or because the accruals basis may be too burdensome to use for digital reporting then that would suggest there is a potential problem with the proposed mandatory reporting requirements. We do not consider providing an additional accounting approach with a 'pick and mix' choice of EoY adjustments is an appropriate way to simplify reporting for small businesses.

7.1.2 We are concerned that the potential introduction of a third method of reporting business income and expenses will lead to greater confusion for unrepresented small businesses who

may not understand which method would suit them. This could result in more compliance errors based on timing differences and possibly result in disengagement with HMRC.

7.1.3 We think that some unrepresented small businesses will see the description of ‘simpler business reporting’ and decide to use this accounting approach even though it is possibly the most complicated out of the three accounting methods. Given the areas identified for ‘simplification’ (bad debts and closing stock, for example), this approach is also likely to lead to the acceleration of a business’ tax payments.

7.1.4 We are concerned that this new basis would effectively be discouraging businesses from preparing accounting information which, although it may reduce the amount of time required for digital tax reporting, will not help in understanding how a business is operating. Businesses need to have commercial awareness, some will need to perform regular stock-takes or keep on top of slow-paying debtors. HMRC must emphasise the importance of keeping appropriate business records which enable the self-employed to understand all areas of their business and not to assist with their tax obligations only.

7.1.5 This simplified reporting will be difficult for UC and tax credit claimants to use. Self-employed UC claimants will be using a cash accounting system for their monthly reports to DWP and this proposed system would be very different, using EoY reconciliations which are not allowed under the UC monthly reporting requirements. Any UC claimant using this accounting approach would spend significant time preparing different accounts for DWP and HMRC.

7.1.6 Overall, we do not think there is justification to introduce this third approach, although we understand that HMRC want to provide the self-employed and businesses with choices which enable flexibility. However, to benefit from these choices business owners would probably need to actually complete three comparison calculations and in order to do this a sound understanding of how accounts are prepared and how tax profit is calculated is required. Unfortunately many business owners lack the time or interest to have a detailed appreciation of these areas and it will be unrepresented taxpayers who lose out on the potential benefits these choices may provide.

7.2 ***Question 5: Are there other end of year adjustments not listed in paragraph 4.12 which could be simplified within a reporting framework?***

7.2.1 No comment.

7.3 ***Question 6: Would you welcome the four relaxations proposed?***

7.3.1 We think these proposals (and their related restrictions) are too complex for low-income unrepresented businesses to understand and implement and we strongly recommend that it is not implemented, see our comments at paragraphs 7.1.1-7.1.6. Instead of introducing an additional option, we would encourage HMRC to use their resources to promote a better comprehension of the existing accounting methods – the cash basis and the accruals basis. This would enable the self-employed and small businesses to understand how to use these

methods and what the differences are between the two approaches, for example the use of tax losses and the treatment of interest and finance costs.

**7.4      *Question 7: Do you think that the restrictions proposed are appropriate? If not, what restrictions would you suggest?***

7.4.1    No. See the comments above for Question 6 (paragraph 7.3.1) and our general comments at paragraph 7.1.1.

**8          *Reforming the capital/revenue divide within cash basis***

**8.1      *General comments***

8.1.1    This is an area of tax which many small businesses struggle to understand and possibly make genuine errors when completing their tax returns. We welcome suitable approaches which simplify this tax treatment so it is easier for unrepresented taxpayers to understand.

**8.2      *Question 8: Do you believe that simplifying the capital/revenue distinction as suggested in paragraphs 5.7 to 5.13 would simplify reporting for businesses within the cash basis?***

8.2.1    Suitable simplification of the capital/revenue rules would be beneficial to unrepresented small businesses as long as appropriate and clear guidance is provided so that taxpayers can understand the new rules so as to prevent errors being made.

8.2.2    However, business owners need to be aware that using the cash basis and having large capital expenditure in a particular accounting period may result in a tax trading loss. This could be problematic, for example, if the business is using these accounting reports when seeking business finance as the cash basis would show net cash outgoings and a trading loss, whereas using the accruals basis could potentially show a capital asset being depreciated over time.

8.2.3    It would be helpful if HMRC could clarify whether businesses using the cash basis could make a separate decision on whether they would be able to use these revised capital/revenue rules or the current rules. Paragraph 5.13 of the consultation<sup>1</sup> states 'Businesses wishing to obtain tax relief for this element of property purchase should follow the ordinary rules'. It should be clarified whether they will still be able to use the cash basis but use the existing rules for any transactions involving capital assets or have to move to the accruals basis or the proposed simpler business reporting? If it is the latter then the commercial reasons for allowing a move from the cash basis should include a change of tax treatment following the acquisition of a property.

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<sup>1</sup>[www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/545708/Business\\_Income\\_Tax-Simplifying\\_tax\\_for\\_unincorporated\\_businesses-consultation.pdf](http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/545708/Business_Income_Tax-Simplifying_tax_for_unincorporated_businesses-consultation.pdf)

**8.3 Question 9: Can you identify any specific caveats which might be needed to ensure that the new rules operate as intended? Are there any potential tax planning opportunities which the current rules would not prevent?**

8.3.1 No comment.

**9 Assessment of impacts**

**9.1 Question 10a: If the cash basis entry threshold is raised would you consider using the cash basis, or advising your clients or members to use it? If so please provide details of anticipated impacts, including both one-off and ongoing benefits and costs.**

9.1.1 As a charity providing information to help unrepresented, low-income self-employed people understand the tax system, any such changes will result in additional work due to writing and presenting new material for our websites and other welfare advisory groups so they can assist their 'clients'. There will therefore be a cost in writing and presenting any new material.

9.1.2 Although we do not offer tax advice to individuals we regularly receive questions from people struggling to understand their tax position. In our experience, changes to the tax system, especially where a taxpayer has a choice of approaches, can result in confusion and requests for further help. We anticipate that such large changes to the tax system, as proposed in all six of the MTD consultations, will result in more questions and requests for assistance to the voluntary organisations which specialise in tax.<sup>1</sup> Specific funding should be made available for voluntary sector organisations which will have to advise on some of the key areas of MTD in due course.

**9.2 Question 10b: If the proposed basis period reform is taken forward, how do you think this would impact on business admin burdens? If possible, please provide details of anticipated impacts, including both one-off and ongoing benefits and costs.**

9.2.1 From our experience, many unrepresented businesses will be unaware of what options they have available and what choices they can make. There will be an initial impact as self-employed taxpayers need to consider what accounting periods to use and this will result in an initial cost of time spent by the taxpayer. Going forward, as long as the business does not experience any significant changes in trading activity then we would expect there to be minimal costs involved.

9.2.2 With regard to the proposed basis period reform for UC claimants we reiterate our concerns stated at paragraph 6.3.2. There will still be a significant cost of time (and possibly professional fees) for UC claimants in preparing potentially different monthly accounts for

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<sup>1</sup> The tax charities which provide direct advice to low-income people are TaxAid ([www.taxaid.org.uk](http://www.taxaid.org.uk)) and Tax Help for Older People ([www.taxvol.org.uk](http://www.taxvol.org.uk)).

HMRC and DWP. It is imperative that the two cash accounting systems used for UC and tax reporting purposes are fully aligned.

9.3 ***Question 10c: If the reduced reporting framework is introduced, please provide details of how this will affect your business or your clients or members, including details of both the expected one-off and ongoing benefits and costs for:***

- ***Familiarisation with the new scheme and updating software or systems***
- ***Having to make fewer adjustments than would be required under UK GAAP***

9.3.1 The introduction of a new accounting basis to report business profits will result in additional questions to the voluntary sector. At LITRG, we would need to provide information and general guidance on our websites as the information on GOV.UK is usually not sufficiently detailed to enable unrepresented taxpayers to make informed decisions. We would envisage this to be largely a one-off cost, but with time needed to keep it up to date each year.

9.4 ***Question 10d: If the revenue/capital divide is simplified as suggested do you believe that this would simplify reporting for businesses within the cash basis? If so please provide details of anticipated impacts, including both one-off and ongoing benefits and costs.***

9.4.1 For most unrepresented self-employed and small businesses this proposal would simplify the reporting of capital expenditure. However for it to be effective businesses using the cash basis must be aware of the new rules so they can report their business expenditure correctly.

9.4.2 The introduction of any further changes to business tax rules will impact on unrepresented small businesses as they will need to be made aware of any changes and be provided with clear guidance, enabling them to make informed choices. There will be an initial cost to organisations such as LITRG in providing this new guidance on our websites.

9.5 ***Question 10e: Please tell us if you think there are any other impacts, benefits or costs not covered above.***

9.5.1 We recommend that HMRC work alongside DWP to consider ways to reduce the administrative time and costs for UC claimants. As the current proposals could result in self-employed UC claimants having to prepare different reports, it is imperative that this is resolved by fully aligning the cash accounting rules for tax and UC, and by introducing a single reporting method for both HMRC and DWP purposes, before UC claimants come within the scope of MTD.