Low Incomes Tax Reform Group.
A voice for the unrepresented.

Autumn Finance Bill 2023
Clause 16 and Schedule 10 – Provision relating to the cash basis
Briefing from the Low Incomes Tax Reform Group (LITRG)

1 Executive Summary

1.1 Clause 16 and Schedule 10 change the current rules for reporting information on self assessment tax returns for most unincorporated businesses. The aim is to allow more sole traders and partnerships to be eligible to use the cash basis rather than the accruals basis (also known as traditional accounting) which may simplify the preparation of their business accounts.

1.2 We are generally supportive of these changes as making the cash basis the default way to prepare business accounts will formalise the way some low-income unrepresented traders are currently, and technically incorrectly[1], completing their tax returns.

1.3 However, we have a number of concerns about the expansion of the cash basis. These are:

- the timing of the new rules starting from April 2024 as this is also the first year of the new Basis Period Reform rules (following the 2023/24 transition year);
- there needs to be improved guidance clarifying areas which low-income unrepresented businesses struggle with, such as the timing of receipts and payments under the cash basis, in particular when trading through digital platforms;
- HMRC need to develop a compliance approach for taxpayers who realise they have been preparing their tax returns incorrectly using the cash basis but not electing to do so. We recommend that HMRC apply a sensible and 'light-touch' approach regarding any genuine errors which come to light following the move to these new rules.

2 About Us

[1] If the taxpayer has been consistently using the cash basis but not made a formal election on their tax return then the tax return will be technically incorrect but there will probably be no tax revenue lost over a period of years because any differences between the cash basis and accruals basis are mainly timing differences.

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2.1 The Low Incomes Tax Reform Group (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.

2.2 LITRG works extensively with HM Revenue & Customs (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.

2.3 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.

3 Detailed comments

3.1 Clause 16 and Schedule 10 change the current rules for reporting accounting information on self assessment tax returns for most unincorporated businesses[1] by making the cash basis the default method for calculating income and expenditure and removing the upper turnover limit on its use (£150,000 per annum, or £300,000 for universal credit claimants). The aim is to allow more sole traders and partnerships to be eligible to use the cash basis rather than the accruals basis (also known as traditional accounting or GAAP rules) which may simplify keeping business records and preparation of their business accounts. The cash basis broadly allows for income to be accounted for when it is actually received and expenses when they are paid.

3.2 HMRC consulted[2] on proposed changes to expand the cash basis, to which our response was generally positive as it will be helpful to those we represent[3]. We considered some of the proposed changes to be more useful to low-income unrepresented businesses than others, for example the use of a default cash basis would be a simplification but the increase in a turnover threshold would not particularly affect this cohort[4].

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[1] Some businesses are not eligible to use the cash basis, as listed in the Business Income Manual on GOV.UK: https://www.gov.uk/hmrc-internal-manuals/business-income-manual/bim70010. These exclusions from the cash basis will continue - see the Autumn Finance Bill at Schedule 10, paragraph 11.

[2] Expanding the cash basis for the self-employed: https://www.gov.uk/government/consultations/expanding-the-cash-basis/expanding-the-cash-basis-for-the-self-employed--2

[3] LITRGs response to HMRC's consultation on Expanding the cash basis for the self-employed: https://www.litrg.org.uk/latest-news/submissions/230606-expanding-cash-basis-self-employed

[4] Following HMRC's consultation into Expanding the cash basis for the self-employed, the Autumn Finance Bill will in fact remove the turnover threshold instead of raising it.

3.3 We understand that some unrepresented businesses are preparing their tax returns using the cash basis but not formally electing to do so as they are not aware they need to make an election[1]. By changing the legislation so the default way to prepare accounts for self assessment is by using the cash basis instead of the accruals basis, this will resolve this largely technical issue and still allow taxpayers to elect to use the accruals basis if they choose to do so, or are not eligible to use the cash basis.

3.4 However, we do have a number of concerns regarding the changes to the cash basis, some of which can be alleviated by improved guidance and communications (as detailed in 3.6 below). One of our concerns is these changes will start from the 2024/25 tax year which is also the first year of the new basis period reform (BPR) rules for unincorporated businesses, following the BPR transition year (2023/24). We are concerned that several significant changes are being implemented over the next few years which will affect unrepresented businesses and which may result in confusion over the new rules and potentially lead to errors being made on their tax returns.

3.5 However, we accept that it may be difficult to delay these new rules until after the BPR spreading period, which ends in the 2027/28 tax year, because the new Making Tax Digital for income tax (MTD) rules will start from April 2026 for some businesses. Therefore, although it's not ideal, our overall feeling is that it would be helpful to have the changes to the cash basis in place before MTD commences.

3.6 As explained above, there are numerous changes which will affect many unrepresented businesses over the next few years, so it is imperative that HMRC expands its GOV.UK guidance on the cash basis to help unrepresented sole traders and partnerships. These businesses require detailed guidance covering areas such as the timing of receipts and payments under the cash basis, especially when trading via a digital platform. For example, we are aware of confusion regarding when income is received due to the various ways the platforms transfer sale proceeds to sellers, which means that some traders are unsure of when to account for their sales: is it the point funds are paid to the platform; or at the point funds are distributed to the seller (and sometimes this may be indirectly to a PayPal account and then paid to the business bank account)?

3.7 We are pleased that HMRC recognise 'the need to update this guidance on the cash basis targeted at small businesses, taking into specific consideration the needs of unrepresented taxpayers and those who may be moving from accruals into the cash basis'[2]. We would strongly recommend that the

[1] Research by HMRC has also confirmed this lack of awareness of making an election to use the cash basis; 'When discussing the proposals with self-employed people, many did not realise that the cash basis had to be elected into' under the Guidance and education heading in HMRC's Expanding the cash basis - summary of responses: https://www.gov.uk/government/consultations/expanding-the-cash-basis/outcome/expanding-the-cash-basis-summary-of-responses

[2] From Guidance and education under Next Steps in HMRC's Expanding the cash basis - summary of responses: https://www.gov.uk/government/consultations/expanding-the-cash-basis/outcome/expanding-the-cash-basis-summary-of-responses

updated guidance includes scenario-based examples and sits on the main GOV.UK pages and not in the Business Income Manual (which is mainly used by HMRC staff and professional tax advisers).

3.8 HMRC need to consider how they will inform unrepresented unincorporated businesses of these new changes from April 2024. Particular points to make clear are: the changes making the cash basis the default method; being able to use sideways loss relief under the cash basis; and that there will be no general allowable deduction for interest charges up to £500 (instead there will be no limit for interest for business purposes only).

3.9 Additionally, guidance and communications from HMRC must also cover the cohort of unrepresented taxpayers who may have been using the cash basis without formally electing to do so and consequently do not understand if there are transition rules which apply to them. Clear messaging will be needed to stop any confusion. Therefore, we welcome the suggestion that 'HMRC will consider the feasibility of launching a wider communication campaign about the cash basis'[1] and strongly recommend this communication strategy proceeds.

3.10 HMRC need to develop a compliance approach for taxpayers who realise they have been preparing their pre-2024/25 tax returns incorrectly using an informal version of the cash basis but not electing to do so. Other errors may arise by incorrectly using a 'hybrid' version, for example electing to use the cash basis but not realising that there was an interest restriction of £500 and including a higher amount of interest as an allowable business expense. In many cases, we consider that where there are genuine inadvertent errors such as these, they could be corrected by either formally electing to use the cash basis or by changing from the cash basis to the accruals basis (for example if the cash basis interest threshold has been reached), which should not change the overall tax position. Therefore, we recommend that HMRC apply a 'light-touch' regarding any genuine errors which come to light following the move to these new rules, as many of these issues should disappear from the 2024/25 tax year onwards.

LITRG
2 January 2024

[1] From Guidance and education under Next Steps in HMRC's Expanding the cash basis - summary of responses: https://www.gov.uk/government/consultations/expanding-the-cash-basis/outcome/expanding-the-cash-basis-summary-of-responses