Making Tax Digital and cash basis accounting for traders and landlords: Draft Finance Bill 2017 legislation

Management of taxes **OMB**

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The CIOT and LITRG have commented on the draft primary legislation published on 31 January 2017.

The government published draft legislation for a one month consultation on 31 January 2017 containing the enabling provisions for the introduction of digital record keeping and quarterly reporting from the start of the 2018/19 tax year. On the same date, draft legislation introducing a new property cash basis (PCB) and increasing the entry and exit thresholds for the existing trading cash basis (TCB) was also published. Both these measures will come into effect from 6 April 2017.

Digital record keeping and quarterly reporting

The draft legislation covers the following:

a) Which businesses will be in scope;
b) Exclusions and exemptions for specified businesses and business activities;
c) Digitally excluded exemption;
d) Regulation making powers for the periodic (quarterly) updates;
e) Regulation making powers for the end of period statement;
f) Regulation making powers for digital record keeping;
g) Supplementary powers for electronic communications.

Both the CIOT and LITRG are concerned that the requirements of MTD will come into force before there has been adequate time to prepare and consult on the legislation. We remain of the view that the timeframe for mandating MTD should be extended

for at least a year, so that the fullest consultation and scrutiny of both primary and secondary legislation can take place. By delegating key details to secondary legislation, and using the negative procedure (rather than the affirmative procedure) it is more or less inevitable that the secondary legislation will receive little if any Parliamentary scrutiny. At some places, it appears that material delegated to secondary legislation can then be further delegated to directions and notices. This is giving HMRC extremely wide powers to make provisions without any scrutiny at all, which in our view is unacceptable for what is one of the biggest changes to the tax system in decades.

In addition, LITRG compared and contrasted self-assessment, which was phased in over a period of some three years during which there was extensive debate on and scrutiny of the primary legislation both in Parliament and through consultation, with the draft legislation for MTD with its 28 day consultation period and its implementation only just over one year after first being exposed for comment.

A new Property Cash Basis

Individuals, and partnerships made up only of individuals, who have a property business will, unless they opt out, have to use the new PCB of accounting from 6 April 2017 if the cash receipts of their property business for the year do not exceed £150,000. In other words, PCB will be the default basis of accounting for these businesses. If they wish to prepare accounts using Generally Accepted Accounting Practice (GAAP accounting) they will have to make an election to use it. The policy objective of the measure is to provide a simplification for landlords with straightforward tax affairs who do not require accounts prepared under GAAP for any reason other than to meet their tax obligations.

The CIOT has commented saying that we are not convinced that the policy objective of simplification will necessarily be fulfilled in all cases. It is inevitable that providing a choice of accounting bases will bring with it complexity. Both CIOT and LITRG believe it is unfortunate that there is inconsistency of approach between the TCB and the PCB when deciding which basis of accounting to apply, as this introduces a level of complexity which could have been avoided.

Once within MTD, landlords will be required to submit quarterly updates to HMRC, to coincide with the tax year, with an end of year statement required by the following 31 January. CIOT give an example to highlight the issues that could arise by

2020/21, by which time the interest relief restriction in section 272A ITTOIA 2005 (restricting deductions for finance costs related to residential property) will have come fully into effect. We think the system is likely to encourage taxpayers to use the default cash basis for quarterly returns and then reconsider this once the figures are available for the whole year, potentially reducing the value of those submissions.

LITRG has cautiously welcomed the introduction of the new rules overall, as the option to use a simplified accounting basis may be helpful to landlords with the introduction of MTD, provided it is not too complex to understand, detailed guidance is available to assist unrepresented landlords and it will not result in an overall tax disadvantage.

Increasing the threshold for the TCB and reforming the capital v revenue divide within the TCB

The current rules for the calculation of profits under the cash basis of accounting ('the cash basis') which are in ITTOIA 2005 section 33 and 33A do not allow a deduction for capital expenditure unless such expenditure would qualify for capital allowances as plant and machinery and is not expenditure on a car. The current rules mean that in practice the taxpayer must first consider whether an item of expenditure is capital in nature and then whether the expenditure would qualify for capital allowances.

The legislative changes proposed replace the current rules with a more limited disallowance of capital expenditure incurred in relation to assets which are not used up in the business over a limited period. The policy objective is to simplify the rules for the deduction of capital expenditure within the trading cash basis.

At the same time as these changes, the threshold for the TCB is being raised to £150,000, that is with effect from 6 April 2017, and the exit threshold has been increased to £300,000, so larger businesses that may have more complex affairs and be incurring a variety of different types of capital expenditure, will soon become eligible to use it. It is the CIOT's view that the reforms to the rules regarding the capital v revenue divide would therefore have been better implemented alongside retaining the entry threshold at the level of the VAT registration threshold (that is £85,000).

In our response, we explain why we are not convinced that the policy objective of simplification will necessarily be fulfilled in all cases. We are also concerned that the changes could lead to more errors unless HMRC provide very clear and accessible guidance and the MTD software contains consistent and accurate nudges and prompts.

LITRG remain concerned that until there is full alignment between the cash basis used for reporting tax to HMRC and the cash basis used by DWP for self-employed universal credit (UC) claimants, then there will still be a significant additional administrative and cost burden on UC claimants.

As these rules are being introduced from 6 April 2017, LITRG also consider it crucial that detailed guidance about all the changes, in both digital and non-digital forms, is available in the very near future as landlords and the self-employed will need to consider whether to keep their business records using the cash basis or the accruals basis at or before the start of the new tax year, and what changes they need to make to their record keeping procedures.

The CIOT's full responses can be found on the CIOT website:

Draft Finance Bill 2017: Reforming the cash basis expenditure rules

Draft Statutory Instrument 2017: Increasing cash basis thresholds for unincorporated businesses

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