Cash basis for property businesses

OMB Personal tax

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Following consultation, the draft provisions introducing the cash basis for the calculation of the taxable profits of property businesses were included in Finance (No. 2) Bill 2017 at Clause 19 and Schedule 5. These provisions were dropped from the pre-election Finance Act 2017. At the time of writing we do not know whether (and from what date) the provisions may be re-introduced. However, as the proposed statutory cash basis for property businesses owes its origin, at least in part, to Making Tax Digital, it is reasonable to assume that it will be re-introduced. Therefore we continue to raise issues with HMRC based on the draft provisions.

Transitional adjustments when moving between GAAP and the cash basis

Members are concerned about the operation of the transitional adjustments when moving between GAAP and the cash basis either in the first year to which the cash basis applies or in each future year (when one of the Conditions A-E is met such that the cash basis is no longer the default basis). Guidance in this area will be of particular significance for furnished holiday lettings. When booking holiday accommodation it is common practice to pay one third of the cost of the stay in advance with the remainder due eight weeks prior to the stay. As a result, payments held and carried over under the accruals basis at the year-end can be substantial. We have asked HMRC to cover this aspect, with examples, in the guidance.

Loan interest – loan to value restriction

Landlords using the cash basis will be able to make deductions for interest on loans taken out for their property business subject to existing restrictions on loan interest for residential properties and a further limitation where the value of underlying loans exceeds the value of properties in the property business (Schedule 5 new sections

307C and 307D). Where L (loan) exceeds V (value), loan interest is capped at V/L x interest.

We have pointed out that the apparent effect of Condition C of section 307C is to deny interest relief where a taxpayer has one let property but ceases to let it before 5 April. This is because V (value) is defined as the sum of the values of all the properties involved in the property business on the last day of the tax year.

If a taxpayer has one let property but ceases to let it on, say, 4 April (or any other date other than 5 April), V is zero and consequently no loan interest relief is available at all under the cash basis. It is not clear whether this position is intended. It may affect for example, international assignees who typically let out their homes for the duration of an overseas assignment in order to cover the mortgage costs and then move back in when the assignment ends. In the year of return, the effect of this restriction could mean that relief is denied for interest costs altogether.

We have asked HMRC to clarify the intention.

Treatment of potentially refundable property deposits

The response to the consultation included the following statement in respect of refundable security deposits:

3.14. In line with existing law and practice, there will be no expectation that refundable security deposits should initially be treated as receipts of a business which is operating cash basis. Rather, as now, landlords will be required to account for any retained amounts only once it has been established that any element of a security deposit is legally the landlord's property.

New section 271D (2) (Calculation of profits on the cash basis) says that 'In calculating the profits, receipts of the business are brought into account at the time they are received.'

We have asked whether it is HMRC's view that a refundable security deposit only becomes a receipt under this draft provision when the landlord becomes entitled to retain all or part of the deposit to meet dilapidations or unpaid rent at the end of the tenancy. If that is the case, does this treatment apply equally to the custodial

scheme (where the deposit is paid into the scheme) and the insured scheme (where the landlord retains the deposit but pays insurance premiums into the scheme to protect the tenant’s interest)?

In addition to these points, the CIOT raised other issues with HMRC about the property cash basis at the time the draft legislation was published. This submission can be found on the CIOT website.

We would encourage members to contact us if they identify further issues and anomalies with this legislation.