



BUSINESS INCOME TAX: SIMPLIFIED CASH BASIS FOR UNINCORPORATED PROPERTY BUSINESSES

ICAEW welcomes the opportunity to comment on the consultation paper [Business Income Tax: Simplified cash basis for unincorporated property businesses](#) published by HM Revenue & Customs on 15 August 2016.

This response of 7 November 2016 has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 1 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

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For more information, please contact ICAEW Tax Faculty: taxfac@icaew.com

icaew.com

MAJOR POINTS

Key point summary

1. The full cash basis does not lend itself well to property businesses as it will result in landlords paying their tax liabilities at the whim of their tenants and will not give the predicted certainty. Although the tax payable for the year would be based on rents received it is the effect on the payments on account that causes concern. If a tenant pays a year up front on say 31 March the tax liability for that year will reflect the cash received but the payments on account for the following year could potentially be much too high. As the landlord will not know if his tenant will pay up front again on 31 March he cannot reduce the payments on account until the end of the tax year when he will know what rents have been received.
2. In cases where the rental income fluctuates widely because of the cash basis (fat years and lean years) some taxpayers may cross certain income thresholds in one year but not the next when rent is received late or early, as examples consider:
 - Loss of personal allowance in a lean year because income is below the personal allowance
 - Loss of personal allowance in a fat year because income is over £100,000
 - Loss of child benefit in a fat year because income goes over £50,000
 - Income tax charge on a gift aid payment in a lean year as no tax payable on income
3. The non statutory cash basis outlined in the Property Income Manual (PIM) at [1101](#) should be extended to larger property businesses. At present many landlords operate an informal cash basis in that they:
 - report rent for 12 months without adjusting at each end of the year for any rent overlap period at 5 April and
 - report expenses paid in the 12 months such as the insurance premium or service charge paid in the year without adjusting for prepayments either side of 5 April.Consistent use of this basis results in the correct tax being paid and where the expense varies little year on year the timing difference on when the tax is collected will be negligible. We would welcome confirmation that it is not proposed to stop landlords from being able to use this informal cash basis.
4. It is not appropriate to limit the interest relief for property businesses using the cash basis; it is likely that more property businesses have loans compared to small trading businesses and so will be adversely affected by restricting relief to £500. Interest relief will be restricted in total for landlords of residential property from April 2020 and for those who retain the right to relief such as on furnished holiday lets the interest paid should be deductible in full.
5. It is normal for property investors to take a large mortgage so on a residential property costing say £400,000 a mortgage of £240,000 is not unreasonable with an annual interest charge of potentially £18,000 plus. The £500 interest cap would deter the landlord from the cash basis initially but as interest as a rental expense is phased out landlords of residential properties may be tempted into the cash basis after 2020.
6. In our view if the joint owners of a property can independently decide whether to adopt the cash basis it will lead to unnecessarily complex record keeping.

General comments

7. Digital quarterly reporting of rental income will place an unacceptable burden on many landlords with just one or two properties who receive rental income as a supplement to their other income. The rental income is often a very small proportion of their total income and this additional burden along with other recent changes to the taxation of rental income may cause landlords to withdraw the property from the rental market. They are unlikely to sell the property as many will have bought as part of their retirement planning and will continue to hold the property and let it increase in value.

8. Many landlords with multiple properties will not be able to report the rental income on a property by property basis as for example they may have a single insurance policy for all their properties or they may get a single monthly invoice from a handyman or gardener that covers all the properties. It should be possible to report global figures.
9. With regards jointly owned property, it is not appropriate for a taxpayer's information to be updated by one of the other joint owners of the property particularly if the only way to correct it is by asking the original filer of the information. If one joint owner reports on the cash basis for all the joint owners but some of the joint owners choose an accruals basis they will need additional information from the "reporting owner" and explanations will need to be given to HMRC as to why the amounts are different adding complexity rather than simplicity.
10. It is not clear why trusts are excluded from the cash basis. Paragraph 1.20 says, "The option to use the cash basis would be confined to entities with simple affairs. Companies, trusts, holders of units in unit trusts, real estate investment trusts, partnerships with corporate members, limited liability partnerships and other similar, more complex entities would not be able to use the cash basis." but many trusts have very simple affairs, possibly just one property, so blanket exclusion appears unreasonable.
11. It is not clear what is meant by "tied" in paragraph 2.15 and 2.16 "To be allowable, the mortgages would need to be tied to property assets used in the business" and "for mortgage borrowing costs tied to the property assets used in the business". Currently the loan just has to be used to fund the property business for the interest to be allowable. We would welcome confirmation that eligibility for interest relief will continue to be based on whether the loan is used to finance the property letting business and not what it is secured on.
12. Currently landlords are unable to use the shorthand method of calculating travel costs to their property using 45p per mile but instead have to claim a proportion of the total running costs of their vehicle. As the number of miles travelled is generally very low the calculation and record keeping required is out of all proportion to the amount claimed. Allowing landlords to use the shorthand method would be a tremendous simplification at no cost to the Exchequer.

RESPONSES TO SPECIFIC QUESTIONS

Q1: 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?

13. If the cash basis is offered there is no reason to impose a limit. Also if a limit was imposed would it apply per property or per rental business? This is in contrast to our view that there should be a limit for trading businesses which is because as trading businesses get bigger their affairs are likely to be complicated by stock and multiple debtors/prepayments and creditors/accruals; such complication would generally not apply to landlords.

Q2: Do you feel there is any reason why the cash basis should not be optional for all eligible unincorporated property businesses?

14. Adoption of the cash basis should be entirely optional and not mandatory.

Q3: 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?

15. As the overseas and UK property businesses are entirely separate there is no reason why a landlord should have to opt both in or both out, any elections for the cash basis should be entirely independent. Similarly, elections for overseas and UK furnished holiday lettings should

be able to be made separately from one another and from elections for other property businesses overseas and in the UK.

Q4: 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?

16. The information given in the consultation does not give sufficient information about the impact on payments on account if a lump sum is received in advance for rent.
17. The impact on various allowances such as personal allowance, child benefit, pension annual allowance of higher or lower incomes caused by the cash basis when rents received early or late is not explained.

Q5: 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?

18. In our view separate elections for joint owners could lead to very complex accounting records, far from simplifying the record keeping it is likely to lead to very complicated records.
19. If a landlord is a joint property owner with different people on different properties an election for the individual's property business for the cash basis could result in conflict with some of the joint owners who may not want the cash basis. To avoid this conflict and keep the records simpler an election should be possible on a property by property basis.

Q6: 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?

20. As the two are entirely separate we do not think one should depend on the other.

Q7: Would only recognising deposits that landlords are entitled to keep at the end of a tenancy create unnecessary complexity?

21. The only equitable way to deal with tenant deposits is at the point the landlord becomes entitled. The retained deposit will then be matched by the expenditure incurred to make good the property any balance being repaid to the tenant. If the deposit was taxed on receipt with a deduction for the repayment of the deposit or the cost of repairs the landlord may never get tax relief for the repayment/repairs if it creates a loss in that year and it is the cessation of the property business.
22. The landlord is never entitled to the deposit, it is a sum of money held by the landlord government-backed tenancy deposit protection (TDP) scheme as bare trustee for the tenant and he only becomes beneficially entitled if the tenant fails to pay money due under the lease. The cash basis is a method of calculating taxable income, it cannot impose a tax charge on something that does not belong to the taxpayer.
23. Also in this section paragraph 3.30 says that premiums paid would not be an allowable expense; this is unreasonable. The relief for a premium paid is to create reciprocity with the tax charged on the landlord on the receipt of the premium. It undermines the structure of the legislation to continue to tax the landlord but deny relief to the tenant.

Q8: Do you feel there is anything which has not been considered which could make the cash basis as simple as possible for landlords?

24. Rather than a full cash basis which could cause extreme fluctuations in reported income a variation whereby the rents for the 12 months are reported along with expenses paid in the 12 months without adjusting for prepayments or accruals around 5 April (ie the informal cash basis described in para 3 above which is used by many landlords already) would be much simpler and avoid the wide fluctuations.

25. By the time the landlord is ready to file the annual self assessment it is likely that it will be known if there are any bad debts so there will be no need to pay tax on rent that is subsequently irrecoverable.

Q9: 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.

26. It will be open to landlords choosing to delay banking rental receipts from towards the end of the tax year until the next tax year thus delaying tax payments by a year. Landlords will be able to manipulate their taxable income if they so choose.

Q10: Do you have any comments, not already provided, on any aspect of the proposal?

27. It is unlikely that lenders will accept cash basis accounts should the landlord require to borrow further funds or change lenders so a second set of accounts will need to be prepared on an accruals basis.

Q11: 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.

28. All landlords and their advisers will incur costs from familiarising themselves with the new process for submitting data to HMRC and on new software which if updated annually (best practice for practitioners) will be ongoing, and, for many, new accounting rules too.

29. We anticipate that, overall, the additional costs imposed on all landlords by having to keep digital records and report quarterly to HMRC will outweigh costs saved by those landlords who currently prepare accounts on the accruals basis moving to a cash basis.

Q12: Please tell us if you think there are any other benefits or costs not covered in the summary of impacts.

30. Please see answer to Q11.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory:** tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. **Certain:** in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. **Simple:** the tax rules should aim to be simple, understandable and clear in their objectives.
4. **Easy to collect and to calculate:** a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. **Properly targeted:** when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. **Constant:** Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. **Subject to proper consultation:** other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. **Regularly reviewed:** the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. **Fair and reasonable:** the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. **Competitive:** tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see via <http://www.icaew.com/en/about-icaew/what-we-do/technical-releases/tax>).