



HM Revenue  
& Customs

# Making Tax Digital: Simplified cash basis for unincorporated property businesses

**Summary of responses**  
31 January 2017

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# 1. Introduction

## Background to the Consultation

- 1.1 This [consultation](#) was published in August 2016 as one of six consultations focussing on the government's Making Tax Digital transformation programme. Making Tax Digital aims to transform the UK's tax system, making HM Revenue and Customs (HMRC) into one of the most digitally-advanced tax administrations in the world by 2020.<sup>1</sup>
- 1.2 As part of this transformation programme, one simplification measure proposed is the extension of the cash basis of calculating profits to eligible unincorporated property businesses. An unincorporated property business exists where a person who is not a company receives income from land or property. Many of these people identify themselves as landlords.
- 1.3 The proposal is to allow property businesses with the most straightforward affairs to calculate profits on a cash-in, cash-out basis, minimising the need for complicated accounting adjustments. Users of the **cash basis** calculate profits by comparing income and expenditure actually received and paid, rather than income earned and expenses incurred (usually referred to as "**accruals basis**" of calculating profits). This means that under the cash basis, tax is only paid on income once it has been received. The cash basis requires fewer adjustments than the accruals basis and should prove more straightforward for property business owners moving to a digital system for recording transactions.
- 1.4 The majority of landlords who complete self-assessment returns have only a small number of rental properties and are either running their property business alone, or as part of a simple partnership of individuals. The government has proposed allowing those straightforward businesses to use cash basis to calculate their taxable profits, excluding from scope companies, trusts, holders of units in unit trusts and real estate investment trusts, partnerships with corporate members, limited liability partnerships and other more complex entities.
- 1.5 The cash basis of calculating taxable profits has been available for small eligible trading businesses since 2013 and in the last tax year around 1.1 million small traders opted to use it.
- 1.6 There were 93 written responses to this consultation. A full list of those representative bodies and professional advisers that responded in this way is given in Annex A. In addition, there were 590 responses to a Making Tax Digital online survey and approximately 65 who took part in a question and answer session as part of two HMRC led webinars.

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<sup>1</sup> <https://www.gov.uk/government/consultations/making-tax-digital-bringing-business-tax-into-the-digital-age>  
<https://www.gov.uk/government/consultations/business-income-tax-simplifying-tax-for-unincorporated-businesses>  
<https://www.gov.uk/government/consultations/making-tax-digital-voluntary-pay-as-you-go>,  
<https://www.gov.uk/government/consultations/making-tax-digital-tax-administration>,  
<https://www.gov.uk/government/consultations/making-tax-digital-transforming-the-tax-system-through-the-better-use-of-information>

1.7 During the 12 week consultation period HMRC officials also met with a range of stakeholders including accountants, software developers and representative groups as part of the consultation process.

## 2. Responses

- 2.1. Almost all respondents thought that some property businesses should be allowed to use the cash basis, pointing out that it is a natural fit with how many landlords carry on their business. A smaller number suggested that cash basis rather than accruals basis should be the default position for landlords. In that case, the accruals basis would be available as an optional alternative for those more complex property businesses which need to use accruals accounting for other purposes.
- 2.2. In considering both whether to offer the cash basis as a default for some property businesses and the possible design, the government has considered the responses to a number of specific questions raised in the consultation, as described below.

### **Questions 1, 2 and 6 - Scope of the cash basis for unincorporated property businesses**

- 2.3. The consultation document explained that the cash basis can only be entered by trading businesses with total cash basis receipts not exceeding the VAT threshold. The government sought views on whether to also impose a relevant maximum limit on cash basis use for landlords.
- 2.4. Of the written responses, the majority thought that no relevant maximum limit should be imposed. The Making Tax Digital online survey gave rise to similar results, with 63% of respondents saying that no maximum limit should be imposed. Simplicity was the most cited reason for this.
- 2.5. Of those who thought some maximum limit was desirable, most recommended a limit based on turnover/receipts. The most common turnover/receipts limit suggested was alignment with the maximum entry limit for the cash basis for trading income. Again, simplicity was the most cited reason for linking the two limits.
- 2.6. A small number of respondents suggested it would be more appropriate to impose a limit based on the number of properties held. A number of advisers and representative bodies also questioned the decision to exclude trusts, suggesting this discriminated against family businesses.
- 2.7. For those who have both trading income and property business income, the government sought views on whether their eligibility to use the cash basis for their trading business should affect their eligibility to use the cash basis for their property business.
- 2.8. Almost all respondents thought that there should be no interdependence between the cash basis for trading income and the cash basis for property business income, so that eligibility or election to use the cash basis for trading income would not affect eligibility to use the cash basis for property business income.

### **Question 3 – How should multiple property businesses be treated?**

- 2.9. The consultation also asked whether an individual should be required to opt in for all of their property businesses, or whether they could be able to opt in separately

for each. Most respondents preferred separate opt-ins for each business. Several respondents advised that this would be particularly relevant for those with both overseas and UK property businesses, who might be subject to different reporting requirements for property located in another country. Of the minority of respondents who preferred a global opt-in, many wished to eliminate the potential complexity of having to decide which was the more appropriate basis for each property business.

#### **Question 4 – What information would businesses need to make a decision?**

2.10. The consultation asked whether businesses would need further information to allow them to decide whether to use cash basis. The majority of the advisers who responded felt that their clients would need advice on whether to use the cash basis for their unincorporated property businesses, and would also require assistance with its operation. Some respondents queried whether fluctuations in income as a result of the cash basis would push individuals over certain thresholds such as the child benefit charge or reduction in personal allowance.

#### **Question 5 – Treatment of joint owners of let property**

- 2.11. The consultation asked whether individuals who own property jointly (without being in formal partnership) should be able to make separate choices about which basis to use or if each should be required to report on the same basis. Most respondents thought separate choice for each individual would add complexity and be impractical.
- 2.12. Some of the larger accountancy firms and representative bodies felt that allowing separate choice was a necessary complexity given that the current legislation treats each joint owner as carrying on their own property business.
- 2.13. A number of other respondents thought allowing individuals who own property jointly to use different bases would not increase complexity, as most joint owners would choose to work on the same basis.

#### **Question 7 – Treatment of security deposits**

2.14. Some lease contracts require the tenant to pay a security deposit which is refundable in full at the end of the lease term, provided that the tenant has complied with the terms of the lease. The landlord is taxable only on any element which they have retained, for instance to meet the cost of repairs. The consultation asked whether recognising security deposits for tax purposes only at the end of a tenancy would create unnecessary complexity. 97% of all respondents stated that it would be inequitable to treat deposits as a cash basis receipt, despite the complexity caused by the need to make an adjustment after the lease end.

#### **Questions 8 to 12**

2.15. The consultation asked respondents whether there were any risks of tax avoidance which had not been foreseen; what the likely implementation costs and

benefits would be for businesses and advisers; and whether there was anything that had not been considered that could make the cash basis for property businesses as simple as possible.

#### *Avoidance risks*

2.16. A small number of respondents felt that there was an increased risk of manipulation of timing of receipts and expenses in order to move the tax charge from one year to another to the advantage of the property business owner. This was felt to be particularly the case where rent was being paid on an annual basis: a short delay in rent being received could result in no tax charge for one year, and a double tax charge in a different year.

#### *Implementation costs*

2.17. There was no consensus from advisers and representative bodies on whether giving landlords the choice to use the cash basis instead of the accruals basis would save landlords' time and money. No individuals commented.

2.18. Some advisers and representative bodies thought many landlords would not benefit from the potential time or cost savings because either landlords are already using an informal cash basis or landlords would still need to prepare accruals accounts in order to gain finance, say from banks or building societies. Some also thought landlords would incur additional costs to receive advice from advisers on which basis to use.

2.19. Other advisers and representative bodies thought represented landlords would save money and time, as using the cash basis would be quicker for the advisers, while unrepresented landlords would also benefit from this time saving.

2.20. Eight respondents thought there would be small initial costs to advisers to train their staff on the cash basis and to acquire new software compatible with the cash basis.

2.21. A number of replies to this question focused generally on the questions raised in the other Making Tax Digital consultations. This response paper does not cover those replies, which are addressed in the responses to the relevant consultations.

#### *Other impacts not already covered*

2.22. The proposed treatment of interest, which included restricting the interest on cash borrowings to £500 and only allowing relief for interest on mortgages that were tied to let properties, was unpopular amongst advisers and individuals. Respondents thought it was both unnecessarily complicated and liable to limit the appeal of the cash basis for landlords.

2.23. Landlords' relationship with letting agents was mentioned by several respondents. A large proportion of property business owners rely on letting agents to manage their property rental business. Several respondents considered that under a cash basis of calculating profits, landlords should be allowed to recognise rental income at the date on which the letting agent passed it to the landlord, rather than at the date of receipt by the letting agent.

## 3. Government response

- 3.1. The government would like to thank respondents for taking the time to submit written responses and for the input of landlords, advisers, software developers and representative bodies at meetings. The responses have been helpful in designing the policy.
- 3.2. As a result of the consultation responses, **the government will move ahead with the introduction of a cash basis for unincorporated property businesses.** Legislation will be introduced in Finance Bill 2017 to take effect from April 2017.

### Design details

#### *Eligibility and optionality*

- 3.3. The government has considered whether there should be a maximum limit for use of the cash basis. The government has reviewed information about the landlord population and agrees with many of the respondents that for the largest individual and partnership landlords, the cash basis is not appropriate. Therefore **a maximum limit will be imposed.**
- 3.4. This **will be a receipts limit initially aligned with the entry limit for the cash basis for trading income.** The government has announced that the maximum entry limit for the trading cash basis will increase from the VAT registration threshold (currently £83,000) to £150,000 from April 2017, and this figure will also be used as the entry limit for a property business to use the new property cash basis. Therefore, only property businesses which have receipts not in excess of this limit will be eligible to use the property cash basis. The government expects this will exclude only 0.5% of property businesses that would otherwise have been eligible if no maximum limit was imposed.
- 3.5. Approximately 2.36 million property businesses would still be eligible to use the cash basis, with up to 1.8 million expected to benefit from the savings in administrative burdens.
- 3.6. As suggested by a number of respondents, **the government will make cash basis the default for property businesses.** This will relieve owners of the most straightforward property businesses, many of whom are effectively using an informal cash basis, of the need to make active decisions about which basis to use.
- 3.7. For those eligible for the cash basis, **there will be the choice to opt out and use an accruals basis instead.** Those who have cash basis receipts above the maximum limit will not need to consider the cash basis and will be required to continue to work on an accruals basis.
- 3.8. Taking into account concerns raised by those with both UK and overseas property businesses who may be subject to different reporting requirements in other countries, **the legislation will allow a separate decision to be made for each**



**property business.** The maximum limit and eligibility to use the cash basis will apply to each property business.

- 3.9. **Landlords who also have trading income will be able to make separate decisions about which basis of calculation is most appropriate for their trades or property businesses.** They will not be required to use the same basis of calculation for both.

*Joint owners of let property*

- 3.10. The government acknowledges concerns raised by some respondents that allowing individuals who jointly own property (without being in formal partnership) to separately choose on which basis to calculate their profits could add complexity. However, the government agrees with those respondents that thought this was a necessary complexity given that each joint owner is treated as carrying on their own property business. The government also agrees with those respondents that thought that where possible individuals will chose to align their basis with the other owner(s) of any jointly owned property which would remove the complexity.

- 3.11. Therefore **joint owners of let property will be free to make separate decisions about how to calculate their profits and their eligibility for the cash basis will be considered separately.** The exception to this will be where a property is jointly owned by a husband and wife or by civil partners. That is to take account of existing legislation which requires spouses and civil partners who derive income or profits from any jointly owned asset to split this income or profits either 50/50 or in accordance with the legal ownership. Husband and wife or civil partner joint owners will therefore be required to calculate property business profits on the same basis.

*Interest on loans*

- 3.12. **Landlords using the cash basis will be able to make deductions for interest on loans taken out for their property business on a similar basis as landlords who are using an accruals basis.** This will include a restriction for interest where the value of underlying loans exceed the value of properties in the property business and will be subject to existing restrictions on loan interest for residential properties; recreating the rules under the accruals basis but without the need to prepare accounts.

*Lease premiums*

- 3.13. Where a landlord has received a premium for granting a lease of less than 50 years, or has required a tenant to carry out work on the premises as part of the lease agreement in lieu of such a premium, or has received certain other types of payment connected with the granting or assignment of a lease, the landlord may be subject to both an income tax charge and a capital gains tax charge. To ensure that there is no scope for manipulation of the tax years in which any tax liability arises, the government does not propose allowing landlords to apply a cash basis to such sums. These rules will therefore continue to operate by reference to the date a contract is entered into. In line with the existing treatment for traders using the cash basis, no deduction against rental profits will be allowed

for landlords who have made payments or undertaken work under an agreement of this type.

### **Clarification of specific points raised**

#### *Potentially 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.

#### *Letting agents*

3.15. The government's view is that, rental income and expenses under a cash basis of accounting should be regarded as received and paid at the dates of receipt and payment by the letting agent on the landlord's behalf. This is because letting agents are acting in an agency capacity for their landlord clients and will therefore be collecting rent and paying expenses in the place of their landlords.

3.16. This is opposed from the view of several respondents who thought under the cash basis landlords should be allowed to recognise rental income at the date on which the letting agent passed it to the landlord, rather than at the date of receipt by the letting agent.

3.17. HMRC will make this clear in guidance material published after enactment of the legislation.

## 4. Next steps

### **Draft legislation**

- 4.1. Following this consultation and review, the government has taken the decision to publish draft legislation on the simplified cash basis for unincorporated property businesses for Finance Bill 2017.
- 4.2. This measure will be effective for the 2017-18 tax year onwards.
- 4.3. The draft legislation is subject to consultation and review. Details on how to provide comments will be available with the draft legislation.

### **Making Tax Digital**

- 4.4. Responses to the other Making Tax Digital consultations and next steps can be found online:

<https://www.gov.uk/government/publications/making-tax-digital>

# Annex A: List of respondents

The following representative bodies and professional advisers formally responded to the consultation:

1. Association of Accounting Technicians
2. Association of Chartered Certified Accountants
3. Albert Goodman LLP
4. Association of Taxation Technicians
5. AW Tax Limited
6. Baldwins Accountancy Group
7. BDO UK LLP
8. Berkeley Associates
9. BHP Chartered Accountants
10. Brian Tilbury & Co
11. Buzzacott Chartered Accountants
12. Country and Land Business Association
13. Confederation of British Industry
14. Charter Committee
15. Chartered Accountants Ireland
16. Chartered Institute of Taxation
17. CKLG Chartered Accountants
18. Copson Grandfield
19. Crowe Clark Whitehill LLP
20. Deloitte
21. Digital Advisory Group
22. Duncan and Toplis
23. Elizabeth Whiteley Accountancy Ltd
24. Fenn Cox and Partners
25. FreeAgent
26. Grabett's Chartered Accountants
27. Grant Thornton
28. Greaves West & Ayre
29. Harold Smith Chartered Accountants
30. Hillier Hopkins LLP
31. Howsons Chartered Accountants
32. Institute of Chartered Accountants in England and Wales
33. Institute of Chartered Accountants of Scotland
34. Institute of Certified Practising Accountants
35. Institute of Financial Accountants
36. Intuit Inc.
37. IRIS
38. Kingston Smith LLP
39. KPMG LLP
40. Kreeston Reeves
41. Lambert Chapman LLP
42. Landlords Institute of Northern Ireland
43. Landtax LLP

44. Larking Gowen
45. Lieberman & Co
46. Low Incomes Tax Reform Group
47. M&S Accountancy and Taxation Ltd
48. Menzies LLP
49. MHA MacIntyre Hudson
50. Moore and Smalley LLP
51. Morris Owen Chartered Accountants
52. National Landlords Association
53. National Farmers Union
54. National Farmers Union Scotland
55. Office for Tax Simplification
56. Patricia J Arnold and Co
57. PKF Francis Clark
58. Price Deacon Witham Ltd
59. PWC
60. Rayner Essex LLP
61. RSM Global
62. Sagars Accountants Ltd
63. Sage
64. Saint & Co
65. Sandisons Ltd
66. Sandra Riddle
67. Smith and Williamson
68. Tax Aid
69. Thandi Nicholls Ltd
70. UK200 Group
71. Walter Wright
72. Wolters Kluwer
73. Watts Gregory LLP
74. Whitefield Tax Ltd

8 responses were received from individuals.