



HMRC
Making Tax Digital
Simplified cash basis for
unincorporated property businesses

3 November 2016

About ICAS

1. The following submission has been prepared by the ICAS Tax Committee. The ICAS Tax Committee, with its five technical sub-Committees, is responsible for putting forward the views of the ICAS tax community, which consists of Chartered Accountants and ICAS Tax Professionals working across the UK and beyond, and it does this with the active input and support of over 60 committee members. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants and we represent over 21,000 members working across the UK and internationally. Our members work in all fields, predominantly across the private and not for profit sectors.
2. ICAS has a public interest remit, a duty to act not solely for its members but for the wider good. From a public interest perspective, our role is to share insights from ICAS members in the many complex issues and decisions involved in tax and financial system design, and to point out operational practicalities.

General comments

3. ICAS welcomes the opportunity to respond to the HMRC consultation 'Making Tax Digital: Simplified cash basis for unincorporated property businesses', issued by HMRC on 15 August 2016.
4. ICAS supports the overall objectives of 'Making Tax Digital' (MTD), as set out by HMRC in December 2015. The four 'foundations' are laudable goals, but we have significant reservations about the timescale and the mandatory approach and particularly so for small and medium enterprises. To describe MTD as a reform of tax compliance obscures the reality that it is a colossal IT and change management project affecting some 5.4 million businesses and many more taxpayers. A project on this scale needs careful risk management to maximise both its success and acceptance by users.
5. Use of MTD should be voluntary or, at the very least, voluntary for an initial period whilst the system beds in.
6. ICAS is concerned that MTD proposes that full accounts may be dispensed with for many unincorporated businesses, including property businesses. However, accounts are not simply about tax. They are about profitability, the need for accurate information for decision making, and lending and creditor decisions. Whilst cash accounting should be a useful simplification for micro businesses, or for those with one or two let properties, it is not appropriate for more substantial property businesses.
7. Cash accounting, without an upper turnover limit, would cover property businesses ranging from an individual letting out a former home, which they have been unable to sell; to potentially very large property portfolios run by partnerships.
8. Income from land and property is a specialist area of tax. From rent a room to wayleaves, and sporting rights to holiday homes, it is a broad canvas with its own sub-sets of rules. The starting point for most income from land and buildings is preparation of 'trading' accounts on an accruals basis using GAAP. Specific tax rules then impact the results; bringing, for example, restrictions on loss relief and modifying expenses rules for capital expenditure for furnished holiday lettings. We believe that for more substantial property businesses, there is a danger that without full accounts the business owners will have a lack of understanding, and hence control, over their affairs.

Specific questions

Question 1: 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?

9. The primary target for cash accounting should be the two thirds of individuals making a return for one let property. This suggests that a turnover threshold is appropriate. For simplicity, the VAT threshold could be used.

10. An alternative, still keeping the cash basis focused on the simplest scenarios, would be to have a limit of one, or two, properties. For larger concerns, cash basis is less appropriate.
11. Complex businesses are to be excluded. This is appropriate, but may be hard to define. For example, are holiday lets 'complex'? Having a turnover limit would be a simple way of excluding some of the more complex entities, without the need for detailed and hard to apply rules.

Question 2: Do you feel there is any reason why the cash basis should not be optional for all eligible unincorporated property businesses?

12. Cash basis should be optional. A mandatory basis would bring market distortions between property companies, and unincorporated businesses. It would also have an arbitrary and potentially unfair impact on different unincorporated businesses depending on how the property business and property purchases have been funded.

Question 3: 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?

13. It would be appropriate to have separate elections for overseas and UK property.

Question 4: 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?

14. Property owners are likely to need professional advice to make the best decision about use of cash accounting. Future plans need to be considered as well as the current property portfolio. What is needed is discussion and advice, rather than simply more information.
15. Interest and loss relief restrictions, as well as the impact of furnished holiday letting rules, borrowing and the capital gains position need to be considered. Some property businesses may be better structured via a company. The discussion needed is wider than simply information about cash accounting.
16. As we have noted across the MTD consultations, we remain very concerned about the negative messages about tax agents which are being suggested by publicity around MTD, and questions such as this.

Question 5: 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?

17. The scenario here is potentially complex. The distinction between a partnership business and multiple ownership can be difficult to establish. In a family context, receipt of the rental income may not reflect legal ownership of the property.
18. The simplest arrangement would be to have an election for the property, and not have separate cash basis elections for joint owners, but this is not without difficulties.
19. Individual reporting could bring complications in terms of reporting income and expense separately. How is this to be achieved by linking a digital tax account to accounting records when the joint owners may keep combined records?

Question 6: Should eligibility for the trading income 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. If eligibility for property income is based on turnover, the VAT threshold could be used. Individuals who would be required to register for VAT (or have gross income from trading and rental property equal to the VAT turnover threshold) would not be eligible to join cash accounting for traders or property income.

Question 7: Would only recognising deposits that landlords are entitled to keep at the end of a tenancy create unnecessary complexity?

21. Treating damage and other deposits as income does not seem the correct approach. There would be market distortions based on differing tax treatment of what is essentially the same item.
22. Excluding deposits from income would be appropriate.

Question 8: Do you feel there is anything which has not been considered which could make the cash basis as simple as possible for landlords?

23. There is inherent complexity in property income. The cash basis would be most appropriate for those with the simplest affairs. Further simplification would come at the risk of putting unincorporated businesses at a disadvantage. For example, it might be simpler to ignore the furnished holiday letting rules for cash basis, but this would be inequitable.

Question 9: 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.

24. We have no comments on this question.

Question 10: Do you have any comments, not already provided, on any aspect of the proposal?

25. The existing cash basis does not appear to have a high take up amongst clients of professional firms, though offered, for all the reasons discussed above. It may be that cash basis accounting for property income will be suitable for, and more popular with, unrepresented taxpayers.

Question 11: 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

26. Small unincorporated property businesses are unlikely to have MTD compliant digital accounting systems. The low turnover threshold for MTD (at £10,000 gross income) means that almost all single property rental businesses would fall within the regime.
27. This will involve some costs, particularly in terms of software. The impact of cash basis would not appear to be significant: it is the digitalisation of record keeping and quarterly updates which is the major impact.

b) Not having to keep accruals accounts and prepare calculations in accordance with UK GAAP.

28. The impact here would be minimal. Larger businesses will need GAAP accounts for non-tax reasons, such as to access losses in the early years of a business, support loan applications, enable effective business decisions and determine profit allocation between

partners. For small property businesses the difference between cash and GAAP accounting is modest.

Question 12: Please tell us if you think there are any other benefits or costs not covered in the summary of impacts below.

29. The overall impact of the proposals would appear to be moderate. Represented businesses may be more likely to continue with GAAP for the reasons discussed in question 11 above; simple, unrepresented businesses may opt for cash accounting