Simpler Income Tax for the Simplest Small Businesses

Consultation document
Publication date: 27 March 2012
Closing date for comments: 22 June 2012

Subject of this consultation:	Proposals for introducing a voluntary simplified cash basis for Income Tax and simplified arrangements for certain expenses.
Scope of this consultation:	The proposals are relevant to individuals carrying on a trade or profession as a self-employed sole trader, or in partnership with other individuals. HMRC wishes to consult on the proposed design of the cash basis and simplified expenses.
Who should read this:	Self-employed individuals carrying on a trade, profession or vocation, their advisers, and representative organisations.
Duration:	27 March 2012 to 22 June 2012.
Lead officials:	Alison Bull HM Revenue & Customs and Simon Pemble HM Treasury
How to respond or enquire about this consultation:	Please send responses (or enquiries about the content or scope of the consultation, requests for hard copies, or information about consultation events) to: Hasmukh Haria HM Revenue & Customs, 100 Parliament Street, London SW1A 2BQ Email hasmukh.haria@hmrc.gsi.gov.uk Tel 020 7147 2544
Additional ways to be involved:	HMRC intends to meet with interested parties during the consultation period.
After the consultation:	Subject to the outcome of the consultation it is intended to publish draft legislation in Autumn 2012, for introduction in the 2013 Finance Bill.
Getting to this stage:	The proposals build on the Office of Tax Simplification Review of Small Business Taxation, which reported on 28 February 2012.
Previous engagement:	As part of their review work the Office of Tax Simplification engaged with a wide range of interested parties.

Contents

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1. Introduction

1.1 There are around 3.5 million individuals undertaking a wide range of trades, professions or vocations in the UK. Of these, more than three million have a turnover below £77,000, which is the VAT registration threshold from April 2012.

1.2 At present, all businesses have to use the same rules to work out their trading profits and, therefore, the tax they owe on them. This applies whether the business is a self-employed sole trader starting out or a multinational corporation. These rules are based on accounting practice designed for larger businesses, which means a disproportionate administrative burden in calculating tax for the smallest businesses.

1.3 The Government wants to make it easier for the self-employed sole trader or those in partnership with other individuals (later referred to as 'small businesses') to calculate their taxable income, as well as providing them with more certainty over their tax affairs.

1.4 The Office of Tax Simplification (OTS) has reviewed how tax rules could be simplified for small businesses, and the Government is now consulting on elements of that review.

What is the Government consulting on?

1.5 A simpler tax system for small businesses. The proposals are that small business will be taxed on the basis of the cash that passes through their books, rather than being asked to spend their time doing calculations designed for big business. This is called a voluntary simplified cash basis (later referred to as 'cash basis').

1.6 The proposals also include simplifying arrangements for some business expenses (later referred to as 'simplified expenses') to complement the cash basis. The cash basis and simplified expenses will be used to calculate taxable income.

1.7 It is not intended to deliver rules to suit every small business as this would constrain the design and limit the simplification.

1.8 HMRC is working with the Department for Work and Pensions to identify how it may be possible to align aspects of the cash basis for tax and self-employment income reporting for Universal Credit.

What is meant by cash basis?

1.9 The system will work on a cash in, cash out basis. For income, it's what you receive when you receive it; for outgoings, it's what you pay when you pay it.

What is meant by simplified expenses?

1.10 In essence, claiming expenses will be a lot less complicated. Where you can't easily distinguish a business expense from a personal one, simplified expenses will help. For instance, someone working from home will be able to apply a flat-rate deduction for using, say, their household gas or electricity rather than having to make individual adjustments when claiming their expenses.

1.11 More information on simplified expenses can be found in Chapter 4 as well as in Annexes A to C.

Does this apply to me?

1.12 The proposals are relevant to small businesses, but they do not apply to everyone (see 3.15).

I'm interested by these proposals, what do I have to do now?

1.13 Chapter 2 outlines what this means for small businesses. If you are a small business and read nothing else in this document, please make sure you read chapter two. Chapters 3 and 4 contain more detail about the proposals and are designed for agents and representative bodies.

1.14 If you wish to respond to this consultation, please send an email to hasmukh.haria@hmrc.gsi.gov.uk or see the alternative contact details in Chapter 7. You do not need to answer all the questions, just those that are most relevant to you.

Chapter Summary

1.15 Chapter 2 summarises what the proposals mean for a small business.

1.16 Chapter 3 explains the current position and sets out detailed proposals for a voluntary simplified cash basis.

1.17 Chapter 4 sets out proposals for simplifying expenses.

1.18 Chapter 5 sets out the Tax Impact Assessment of the proposals.

1.19 Chapter 6 summarises the consultation questions.

1.20 Chapter 7 provides details on how the consultation process works and how you can participate.

1.21 Annexes provide further detail on the following

- Simplified expenses
- The Code of Practice on consultation
- Relevant (current) Government Legislation

2. Small Businesses – what the proposals mean for you

From April 2013, the Government proposes to introduce a voluntary cash basis for small businesses along with simplified arrangements for some business expenses.

Most of this chapter will discuss the cash basis. Details of simplified business expenses can be found in Chapter 4 as well as Annexes A to C.

Who will be able to use the cash basis?

- Most self-employed people, particularly those whose earnings come from their own work
- The OTS proposed small businesses with receipts of up to £30,000 should be able to use the scheme
- The Government would like to explore a higher threshold so that small businesses with receipts of less than £77,000 would be eligible, and they could continue to use it until their receipts rise to more than £150,000 in any year.

Who won't be able to use the cash basis?

- Small businesses with receipts of more than £150,000 in any year
- Property businesses
- Companies and other businesses listed in 3.15.

Who will be able to use simplified expenses?

- Any business using the cash basis must do so
- Any other business (apart from Companies and Limited Liability Partnerships).

Who won't be able to use simplified expenses?

- Companies.

How will the cash basis differ from the normal tax rules?

- No need to understand rules designed for larger businesses
- No need to pay tax until cash is received
- No need to keep complicated records (for example, stock, debtors and creditors), over and above those needed to run a business effectively
- No need to understand capital allowances
- No need to keep detailed records for certain key expenses – use a standard rate instead.

I qualify for the cash basis but will I have to use it?

The new, simpler scheme should be suitable for most small businesses, although some may still wish to use the normal rules. It will be entirely voluntary and any business using the new scheme will be free to go back to the normal rules. Businesses can choose the scheme that works best for them.

What will I need to do to use the cash basis?

- Record all money received in connection with your business and amounts paid to cover allowable expenses
- Record any business miles driven by car or motorcycle and be in a position to assess roughly how much time, if any, you spend working at home for your business
- Select cash basis on your Tax Return form.

How will I calculate my taxable income?

The new cash basis will operate by reference to the tax year (6 April to 5 April). This means small businesses will be able to calculate their taxable income for the tax year by adding or subtracting:

- Receipts in connection with the business received in the tax year
- Payments made in the tax year to cover allowable expenses
- Amounts allowed for simplified expenses.

What expenses will be allowable?

- Those incurred for the purpose of the business, such as anything bought to be sold on
- Some bought assets, such as plant or machinery and vans
- Interest on purchases, provided the purchase itself is an allowable expense. So, trade credit charged by suppliers of goods or services, the interest charges for hire purchase or leasing of plant or machinery, and credit card interest on allowable purchases are permitted.

What expenses won't be allowable?

- Other bought assets such as investments in land, property and shares
- Costs allowed via simplified expenses (see Chapter 4 and Annexes A to C)
- Interest on cash borrowings, such as a bank loan
- The withdrawal of cash for personal use
- Payment of income tax or capital gains tax.

I'm an existing business, so how will I switch to the new cash basis?

To do so may require adjustments to taxable income. HMRC will be providing guidance to help small businesses make the switch. For further details now, see 3.48-3.51.

How will I leave the cash basis?

Businesses will be able to continue using the cash basis until their receipts for the tax year are more than £150,000, in which case the normal tax rules would apply from the beginning of the following year.

Businesses will also be able to choose to switch to using the normal rules before then.

When a business switches from the cash basis to the normal rules, it may also need to make some adjustments to taxable income.

HMRC will be providing guidance to help small businesses leave the cash basis. For further details now, see 3.52- 3.56.

Can I have a say on these proposals?

The Government wants to hear the views of small businesses on the cash basis. Questions the Government is asking people to comment on can be found at the end of Chapter 3, with questions 1, 2, 3 and 10 particularly aimed at small businesses.

The Government also wants to hear the views of small businesses on simplified expenses relating to mileage rates for motor vehicles, business use of home and personal use of business premises. Questions the Government is asking people to comment on can be found at the end of Chapter 4, with questions 12 and 15 particularly aimed at small businesses.

You can write or email HMRC with your responses to these questions. Details of how to do so can be found in Chapter 7. You do not need to answer all the questions, just those that are most relevant to you.

3. Simplified Cash Basis

Introduction

3.1 This chapter sets out the details for the proposed voluntary cash basis.

3.2 This basis is not an alternative method of preparing annual business accounts. It does not apply accounting principles (accruals, matching, fair value accounting, etc), and it provides none of the financial information that annual accounts do (profit/loss, assets, liabilities, etc). It measures cash in and cash out.

3.3 Over the life of a business cumulative cash flows, as measured by the proposed cash basis, should broadly match the cumulative profits of the business. So, the proposed cash basis can provide a suitable alternative basis for calculating taxable business income.

3.4 It is designed with that purpose in mind, and is intended for those who do not need and do not want to prepare annual accounts for business or other purposes.

Current Legislation

3.5 The most directly relevant part of the current tax regime is Part 2 of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA 2005).

3.6 An individual carrying on a business can also receive proceeds which are taxed as capital gains under the Taxation of Chargeable Gains Act 1992 (TCGA1992) rather than Income Tax. (This legislation provides that where the proceeds have already been taken into account in calculating Income Tax they are excluded from Capital Gains taxation.)

Scope

3.7 **The proposed cash basis would be voluntary.** Those unincorporated businesses that satisfy the criteria as set out below would be eligible to use the regime.

Trade, Profession or Vocation

3.8 **The cash basis would be available to those businesses conducting a trade, profession or vocation, that is, to those businesses which would otherwise be within the scope of Part 2 of ITTOIA 2005.** Trade, profession or vocation covers the bulk of the population of unincorporated businesses. The Government may consider developing a similar regime for the smallest property businesses in the future.

Receipts Criteria

3.9 **The OTS proposed that the limit for entry to the cash basis would be receipts for the tax year of less than £30,000. The Government is considering increasing this to match the VAT registration threshold, £77,000 for 2012-13.** The receipts taken into account for this purpose would be those which would be taxable under the cash basis (as specified later in the chapter). This is an existing threshold that is a recognised part of the tax system and therefore will not add further complexity.

3.10 **It is also proposed that a business could continue within the cash basis until the receipts for the tax year exceed £150,000, in which case the normal tax rules would apply from the beginning of the following year.** Setting a higher exit threshold should enable small businesses to grow without the complication of transition until their natural complexity means that the cash basis is no longer the most appropriate for them.

Partnerships

3.11 **It is proposed that general partnerships could use the cash basis -** as long as the partnership meets the receipts and other entry criteria, the partners are all individuals, and either there is no individual treated as controlling the partnership, or any such individual would be eligible to use the cash basis if they were conducting the business as a sole trader.

More than One Business

3.12 **Generally, it is proposed that an individual who undertakes (whether as a sole trader or a partner) more than one unincorporated trading or professional business, would only be eligible for the cash basis if all those businesses are also eligible for, and use, the cash basis.** Additionally it is envisaged that any subsequent use of the 'ordinary' rules for any of those business should have the effect of precluding eligibility for the cash basis for all such businesses. This is because simultaneous use of two different regimes would cut across the simplification benefits of the cash basis.

3.13 **An exception would be where an individual is a partner in a partnership that they do not control that uses the ordinary rules.** So, for example, a partner in a large professional partnership would be eligible to use the cash basis in respect of any separate unincorporated businesses they conduct as a sole trader as long as those businesses meet the eligibility criteria.

Foreign Residence

3.14 **It is proposed that the cash basis would be available to foreign resident individuals, to the extent that they carry on a trade, profession or vocation in the UK, providing that the other eligibility criteria are met.**

Businesses Excluded from the Cash Basis

3.15 **It is proposed that the following businesses would be excluded from the cash basis:**

- **Businesses subject to Corporation Tax (e.g. companies)**
- **Limited Liability Partnerships and any other partnerships not specifically included within the scope**
- **A business that is registered for VAT but is not using the VAT Cash Accounting Scheme**
- **Businesses, e.g. farmers or authors that have a current averaging claim under Chapter 16 ITTOIA 2005**
- **Traders such as farmers who have a current herd basis election or make such an election**
- **Financial trading businesses**
- **An individual who is a member of Lloyds and who is carrying on underwriting business as defined by S184(1) FA1993.**

Entering the Cash Basis

New Businesses

3.16 The cash basis should be the most appropriate regime for most new small businesses, and it is anticipated that most will choose to use it. It is intended to provide guidance through Business Link and other channels to help new (and existing) businesses understand whether the cash basis would be suitable for them, to inform choice about whether to use the cash basis or the normal tax rules.

3.17 **There are two options for how choice could operate in practice for new businesses eligible to use the cash basis – an open choice, or a default approach:**

- **the new business could be presented with an open choice (informed by the guidance) between the cash basis and the normal rules (for instance, by selecting between one or the other when making a tax return)**
- **alternatively the cash basis could apply by default, unless the new business opted-out and elected to use the normal tax rules instead.**

3.18 The “default” option would reduce the need for a new business to devote time and effort to considering which regime to use. But, if they do not need to make an active choice at the outset, would there be any risk that some new businesses would start using the cash basis even though it is not best suited to their needs? (In which case, they might be faced with a more difficult choice in subsequent years as to whether to stick with it, or make the transitional adjustments to switch to the normal rules).

Existing Businesses

3.19 **It is proposed that the normal tax rules would continue to apply to existing businesses unless they made an active choice to choose to switch to the cash basis.**

Reporting Requirements

3.20 **The practical reporting and tax return requirements will need to be considered in the light of the final design details of the Cash Basis.**

General Principles

3.21 **Under the cash basis businesses would apply the rules of the simplified regime to calculate their cash flow, which would be treated as taxable business income**. There would be no requirement to apply generally accepted accounting practice (GAAP) or calculate profits / losses.

3.22 **It is proposed that the cash basis would operate by reference to the tax year.** This should be simplest for individuals applying the regime, as it aligns with the period used for any other (non-business) taxable income, such as investment income.

Income

3.23 **It is proposed that receipts in connection with the trade would be counted as income in the tax year in which the income is received.**

3.24 This would include all receipts treated as trading income by virtue of Part 2 ITTOIA 2005.

3.25 Receipts in the form of ‘money’s worth’ would be included, for example the value of goods or services received from customers.

3.26 Also, a reasonable amount would need to be added to income reflecting any deficiency arising from a transaction being made other than on a commercial basis. (An example would be if after expensing the cost of purchasing stock, an item of the stock was taken for personal use without any actual payment being made for it.)

3.27 Sale proceeds for capital assets (such as plant or machinery) whose purchase costs have previous been relieved would be taken into account as a receipt.

3.28 Where there is a significant reduction in the business use of an asset whose purchase costs have previously been relieved (e.g. a switch to partial private use), then a reasonable amount representing the appropriate proportion of the value of the asset at the time would need to be added to income.

3.29 The cash basis would not treat the following receipts as income:

- Funds introduced by the owner of the business for purposes of financing the business, often referred to as 'Capital Introduced'
- Changes in the form of money, e.g. cash withdrawals from bank accounts
- Loan capital borrowed by the business from third parties for financing purposes
- Proceeds from disposals of durable assets, e.g. land and property, intellectual property, shares
- Refunds of Income Tax, Capital Gains Tax, or Tax Credits.

Expenditure

3.30 **It is proposed that expenses wholly and exclusively for the purposes of the trade would be taken into account when paid.**

3.31 Deductions would be restricted to a reasonable amount if expenditure was excessive because transactions have been made on other than on a commercial basis (for example paying excessive prices for goods or services supplied by a relative).

3.32 **Allowable expenses would include certain capital expenditure.** This would remove the need for capital allowance calculations and claims, and so no capital allowances would be available.

3.33 Capital expenditure on wasting assets such as plant or machinery would be allowable (with the exception of expenditure on cars or motorcycles). Where an asset is used for non-qualifying purposes, for example because it is partly used privately, the proportion of the expenditure that represents the qualifying proportion of use would be allowable as a deduction. (Though, the full cost would be deductible where private use was insignificant / immaterial).

3.34 No deduction will be available for expenditure on more durable assets which hold more of their value for longer or which are capable of giving rise to an income flow (e.g. land and property, intellectual property, shares). It would not be appropriate for purchase of such "investment" assets to be tax deductible.[1]

[1] This ensures income is taxed before it is invested in assets.

3.35 No deduction would be allowable for the purchase, lease or other acquisition of cars or motorcycles. It is proposed that for those using the cash basis a standard mileage rate for business mileage would substitute for these expenses.

3.36 A deduction would be allowed for the purchase cost of other motor vehicles (e.g. vans), unless the business chooses to use the fixed mileage rate allowance for such vehicles. All vehicles of the same type must be treated in the same manner, and the fixed mileage rate could only be used if the business has obtained no relief previously for purchase costs under the cash basis (or through claiming Capital Allowances or Annual Investment Allowance).

3.37 **Payments for use of assets, such as hire charges, rent, royalty payments etc, would be allowable**. (Except for cars, motor cycles and any other motor vehicles for which the standard mileage rate is used).

3.38 **Any interest component of purchase costs will be allowable where the purchase cost is allowable.** Examples include the interest element of hire purchase or leasing charges for plant or machinery, or interest applied by suppliers on late payment of bills for stock.

3.39 **No deduction will be allowed for any of the following expenses:**

- **Entertaining, expenditure for private purposes, bribes etc**
- **Non cash costs such as amortisation of assets or accounting provisions**
- **Payments of Income Tax, Capital Gains Tax or NIC Class 2 & 4**
- **Changes in the form of money, such as purchase of foreign currency**
- **Costs of borrowings, including arrangement fees, capital repayments, and interest.**

3.40 The treatment of interest on cash borrowings is driven by both policy design and practical considerations. Aligning the design of the regime with the economics[2] ensures it is fair and keeps the regime as simple as possible, so there is no need for special connected party rules, avoidance purpose rules, or rules to control arbitrage between regimes.

[2] If the business is getting upfront tax relief for cash paid out (e.g. on purchasing stock or expenses for work in progress), this is an economical alternative to getting relief on any interest payments for borrowings used to make the purchase. So allowing relief for interest on borrowings in the proposed cash basis would amount to double relief for the same economic cost.

3.41 Also, the cash basis would not provide the practical information needed to distinguish cash borrowing financing the business activity from borrowing financing cash withdrawal from the business for personal use.[3] Collecting and calculating this information would involve applying the principles of generally accepted accounting practice, which would cut across the simplification benefits of the cash basis.

3.42 Only a small minority of businesses within the scope of the cash basis currently claim deductions for interest. They will have the choice of using the normal rules, which are designed to provide relief for borrowing, if this suits them better than the cash basis.

Treatment of VAT

3.43 **It is proposed that the cash basis would operate on a VAT inclusive basis.** This means that full amount of receipts and payments would be counted including any VAT element. If a business is registered for VAT then any VAT paid to HMRC would be an allowable expense, and any VAT refund received from HMRC would be taxable as a receipt in connection with the business.

Capital Gains

3.44 For businesses using the cash basis the existing Capital Gains Tax rules would operate as now. These rules provide that where the proceeds have already been taken into account in calculating Income Tax they are excluded from Capital Gains taxation. As similar rules exist in relation to gains and losses on the disposal of assets on which Capital Allowances have been claimed, the boundary between disposals on which Capital Gains Tax is payable and those subject to income tax will be similar to now.

Treatment of negative results

3.45 **If the calculation of taxable income gives a negative result, then this would carry forward to be available to relieve against any subsequent positive result, but no "sideways" relief would be available against any other source of income.** A profit making business can have negative cash flow, and it would not be appropriate to allow relief against other sources of income for a negative result in the proposed cash basis. A business would need to switch to the normal tax rules and calculate its profit / loss before any claim for sideways loss relief could be made.

Specific Reliefs

Qualifying Care

3.46 Qualifying Care Relief would be allowable within the cash basis.

[3] Page BIM45730 of HMRC's Business Income Manual gives a worked example of this practical issue (http://www.hmrc.gov.uk/manuals/bimmanual/bim45730.htm).

Barristers

3.47 Special rules currently allow Barristers or Advocates in practice for a period not more than seven years after commencement of practice to compute their profits on a cash basis.

3.48 **It is proposed to withdraw these current special rules for new barristers.** (Those already using the special rules could continue to use them while they remain eligible to.) Instead the new cash basis would in future be available to barristers whose receipts are within the qualifying thresholds, and so there should no longer be a need for special rules for barristers.

Transitional Arrangements

3.49 Transitional adjustments may be required on entry and exit from the cash basis.

Existing businesses switching to the cash basis

3.50 Before using the cash basis for the first time an existing small business will need to bring its period of account for the purposes of applying the normal tax rules to an end on 5th April. This will be the final period of account using the normal rules.

3.51 When a small business switches to the cash basis it may need to make some adjustments to taxable income. These would be made in the first tax year of the cash basis and are necessary to ensure that receipts are taxed once and only once and expenses allowed once and only once. For example:

- if a business has provided goods or services to a customer in a year in which it used the normal rules and the income was included for tax purposes in that year but the customer does not pay until the business is in the cash basis - then the receipts for the first year of the cash basis will need to be reduced to exclude the income that had already been taxed under the normal rules;
- if a business had bought goods or services in a year in which it used the normal rules and the expenditure was allowed as a deduction for tax purposes in that year but the business does not pay until it is in the cash basis - then the expenses for the first year of the cash basis will need to be reduced to exclude the expenditure that had already been deducted for tax under the normal rules;
- if a business holds stock that has not been allowed as a deduction for tax purposes under the normal rules - then the expenses for the first year of the cash basis will need to be increased to include the cost of such stock;
- if a business receives a vat refund from or makes a vat payment to HMRC in a year when it is using the cash basis in respect of transactions undertaken in a prior year when it was using the normal rules - then income/expenses will need to be reduced by the VAT refund/vat payment.

3.52 For existing capital assets whose purchase would, under the cash basis, qualify for an immediate deduction, any part of the costs, if pooled, that are unrelieved at the time of entry to the cash basis would be allowed as a deduction in calculating the business income in the first tax year of the cash basis. In broad terms the unrelieved written down value (if any) would be allowable as a deduction when entering the cash basis.

3.53 For cars and motor cycles there will be no allowable deduction for unrelieved written down value. (On entry to the cash basis any Capital Allowances pool containing unrelieved expenditure on cars or motorcycles would reduce to zero.) It is proposed that the fixed mileage rate allowance will replace all relief for actual expenditure on purchasing, maintaining and running a car or motor cycle.

Leaving the cash basis

3.54 Where a business switches from the cash basis to using the normal rules, it is important to ensure that receipts are taxed only once in full and expenses allowed only once in full.

3.55 When a business switches from the cash basis to the normal rules it may need to make some adjustments to taxable income. These would be made in the first tax year of the normal rules:

- if a business has provided goods or services to a customer in a year in which it used the cash basis and the customer does not pay until the business is in the normal rules then the receipt will not have been included as a receipt whilst in the cash basis. So, there would need to be an adjustment to include the receipt in the taxable income under the normal rules;
- if a business has bought goods or services in a year in which it used the cash basis but the business does not pay until it is in the normal rules then the expenditure would not be allowed as a deduction for tax purposes in the year in which it used the cash basis. So, there would need to be adjustments to include the expenses as a deduction for tax purposes and for valuation of opening stock in the normal rules;
- if a business receives a vat refund from or makes a vat payment to HMRC in a year when it is using the normal basis in respect of transactions undertaken in a prior year when it was using the cash basis – then income/expenses will need to be increased by the VAT refund/vat payment.

3.56 Generally, plant and machinery will be treated as being in a Capital Allowance pool with nil unrelieved expenditure. Exceptions would be cars or motor cycles which have not previously been subject to Capital Allowance claims, and other motor vehicles for which the mileage rate is used.

3.57 On leaving the cash basis the mileage rate would continue to be used for any cars or motorcycles, to ensure a consistent approach to the treatment of motoring expenses.

3.58 The exit treatment for other motor vehicles (e.g. vans) will depend on the method used within the cash basis. Where the mileage rate is claimed for other motor vehicles while using the cash basis, this method will continue to apply on exit from the regime. Otherwise, the treatment will be the same as for other plant or machinery.

Leaving and re-entering the Cash Basis

3.59 **It is proposed that if a business ceases to use the cash basis and uses the normal rules instead then this would not prevent the business from using the cash basis in the future.**

3.60 It would not be desirable for businesses, or their advisors, to consider afresh every year which basis to use, or to switch backwards and forwards between the cash basis and the normal tax rules repeatedly. The burden of repeated reassessments or transitional adjustments would reduce the benefits of simplification. But, is a statutory restriction on switching needed to control this risk, or would businesses generally stick with one set of rules without the need to legislate for this?

3.61 **Two alternative options are under consideration;**

- **A free choice each year of whether to use the cash basis or ordinary rules each year**
- **A statutory restriction, for instance based on a time period before which any voluntary change between ordinary and cash basis can be made.**

Costs and Benefits

3.62 The costs and benefits are considered in Chapter 5.

Other Options Considered

3.63 The Office of Tax Simplification considered a full range of options in conducting their Small Business Review. This consultation document is focused on the particular options they recommended.

Questions

Question 1	**The Government is considering that to qualify to use the cash basis, a small business' receipts would be less than £77,000 in 2012-13 and would be required to leave the cash basis when their receipts are more than £150,000. Do you think these entry and exit limits are appropriate?**
Question 2	**If you don't think the entry and exit limits above are appropriate, why not?**
Question 3	**If you don't think the proposed entry and exit limits above are appropriate, what figures would you suggest instead?**
Question 4	**Should new small businesses be required to make an active choice between the cash basis and the normal rules? Alternatively should the cash basis apply to a new small business by default, unless they indicate otherwise?**
Question 5	**Are there any issues or transactions relevant to small businesses eligible to use the cash basis that have not been considered or addressed adequately?**
Question 6	**Are there any significant tax avoidance risks, which would not be adequately controlled by the proposed design?**
Question 7	**Do you agree that the same rules should apply to barristers or advocates, and the current special rules for barristers or advocates should be withdrawn?**
Question 8	**Is a statutory restriction on switching between the ordinary and cash basis needed? If so, how should the restriction operate?**
Question 9	**Do you have any other comments on the details of the proposed design of the cash basis?**
Question 10	**What are the pros and cons, as well as any other implications, of the cash basis? Please list these.**
Question 11	**Do you have any comments on the tax impact assessment in Chapter 5?**

4. Simplified Expenses

Overview

4.1 In conjunction with a cash flow based regime the Government proposes to introduce certain simplified expenses rules in order to reduce further the administrative burden on small business.

4.2 **It is proposed that certain simplified expenses should be an integral part of the cash basis:**

- **Standard mileage rate for business use of cars or motorcycles**
- **Flat rate expenses for business use of home**
- **Flat rate adjustment for personal use of business premises.**

4.3 Choosing to use the cash basis would involve using these simplified expenses, rather than calculating actual expenses for business use of home, cars or motor cycles, or making a case by case apportionment in relation to personal use of business premises.

4.4 These are areas where business and personal expenses can be most intertwined, which can make the calculation of actual business expenses particularly difficulty and uncertain for small businesses.

4.5 **Also, those using the cash basis could choose to use the standard mileage rate for other motor vehicles, such as vans, rather than calculating actual expenses.**

4.6 **It is proposed that unincorporated businesses using the normal tax rules could choose to use any of these simplified expenses rules.**

Standard Mileage Rate for Business Use of Motor vehicles

4.7 **It is proposed that fixed allowances for business mileage would replace all relief for actual expenditure on purchasing, maintaining and running a motor vehicle.** This would mean there was no need to identify the actual costs of purchasing and running the motor vehicle, and apportion those costs between business and personal use.

4.8 Where a business has a choice about whether to use standard mileage rates, the business would have to treat all motor vehicles of the same kind in the same way.

4.9 It is proposed that standard mileage rates could only be used for motor vehicles other than cars or motorcycles (e.g. vans), if no relief has previously been claimed, partially or in full, either under the normal rules (Capital Allowances) or under the cash basis.

4.10 Where mileage rate is claimed for any motor vehicle(s) while using the cash basis, the business would be required to continue to using the mileage rate approach in respect of the particular motor vehicle(s), if the business exited from the regime.

Flat Rate Expenses for Business Use of Home

4.11 Individuals are currently entitled to a deduction where they use part of their home solely for business purposes.

4.12 **It is proposed that a deduction per month will be allowable if the certain criteria are satisfied. Two options are under consideration; a 3-tier banded rate and a simpler single fixed rate.**

4.13 This allowance would be claimed as an alternative to claiming a proportion of the actual costs. No deductions for any actual expenses relating to use of home could therefore be claimed.

Flat Rate adjustment for personal use of business premises

4.14 Some individuals operating small businesses such as guest houses use part of their business premises (e.g. premises subject to business rates) for personal accommodation.

4.15 **It is proposed to introduce a 3-tier banded flat rate adjustment to actual costs to allow for private use of the premises.**

Telephone and internet services

4.16 Small businesses may incur expenditure on business telephone or internet services where the difficulty of identifying small private use elements is disproportionate to the sums involved.

4.17 **It is proposed that where private use does not form a significant / material proportion of the service use, the full costs of expenditure on telephone and internet services would be allowable as a deduction.**

Subsistence

4.18 Small businesses may incur subsistence costs associated with occasional business journeys outside the normal pattern.

4.19 HMRC intends to review the current guidance concerning subsistence costs and update it where appropriate, in order to provide more certainty for businesses.

Stationery and related items

4.20 Currently small businesses often incur expenses on stationery and related items (such as toner, printer ink etc). These can be small infrequent amounts that can be difficult to identify or apportion between business and private use.

4.21 **It is proposed that for stationery and related items purchased for both business and personal use, as an alternative to apportioning actual costs, estimates of unit costs could be used (e.g. per business letter).**

Costs and Benefits

4.22 The costs and benefits are considered in Chapter 5.

Questions

Question 12	**Would a 3-tier banded rate or single fixed rate for business use of home strike the most appropriate balance between simplification and fairness?**
Question 13	**Are there any issues or transactions relevant to businesses eligible to use simplified expenses that have not been considered or addressed adequately?**
Question 14	**Do you have any other comments on the details of the proposals for simplified expenses?**
Question 15	**What are the pros and cons, as well as any other implications, of simplified expenses? Please list these.**
Question 16	**Do you have any comments on the tax impact assessment in Chapter 5?**

5. Tax Impact Assessment

Cash Basis & Simplified Expenses

Summary of Impacts

Exchequer impact (£m)	2011-12	2012-13	2013-14	2014-15	2015-16
	+/-	+/-	+/-	+/-	+/-
Cash Basis Simplified Expenses	-	-	-	-	-
	-	-	-	-	-
	Cash Basis is expected to decrease receipts by approximately £420m in 2014-15 and increase receipts by approximately £120m in 2015-16 and have negligible impact for future years. The final costing will be subject to scrutiny by the Office for Budget Responsibility, and will be set out at Budget 2013. Simplified expenses are expected to increase receipts by approximately £20m per annum. The final costing will be subject to scrutiny by the Office for Budget Responsibility, and will be set out at Budget 2013.				
Economic impact – Cash Basis and Simplified Expenses	This would be a significant simplification for small unincorporated businesses, which face disproportionate tax admin burdens. It would make it easier and cheaper for small business to calculate tax liabilities by no longer having to compute profits in accordance with GAAP, or having to apportion certain expenses between personal and business use. Switching to this system will result in the taxation of some income being delayed for some businesses leading to an upfront cost to the Exchequer, but a cash flow benefit to the businesses concerned.				
Impact on individuals and households	The impact of the proposals will depend on degree of alignment that is feasible with other income calculations individuals and households may need to make for other purposes, such as income assessment for Universal Credit or other benefit entitlement.				
Equalities impacts	The proposals relate to a voluntary simplified scheme to compute business income for tax purposes and as such no adverse impact on the equality of protected groups has been identified.				
Impact on businesses and Civil Society Organisations	Reduced admin burden on small unincorporated businesses e.g. less time spent apportioning income and expenditure to accord with UK GAAP. More certainty for small business over their tax affairs and when dealing with HMRC.				
Impact on HMRC or other public sector delivery organisations	The impact of the proposals has not yet been fully evaluated when taken as a package. The full details of the proposal have not yet to be settled and the changes that might be required have therefore not been formally assessed.				
Other impacts	The proposals relate to a voluntary simplified scheme for the smallest unincorporated businesses to compute business income for tax purposes. As such a reduction in administrative burden is expected for those small businesses choosing to use the scheme.				

6. Summary of Consultation Questions

Question 1	**The Government is considering that to qualify to use the cash basis, a small business' receipts would be less than £77,000 in 2012-13 and would be required to leave the cash basis when their receipts are more than £150,000. Do you think these entry and exit limits are appropriate?**
Question 2	**If you don't think the entry and exit limits above are appropriate, why not?**
Question 3	**If you don't think the proposed entry and exit limits above are appropriate, what figures would you suggest instead?**
Question 4	**Should new small businesses be required to make an active choice between the cash basis and the normal rules? Alternatively should the cash basis apply to a new small business by default, unless they indicate otherwise?**
Question 5	**Are there any issues or transactions relevant to small businesses eligible to use the cash basis that have not been considered or addressed adequately?**
Question 6	**Are there any significant tax avoidance risks, which would not be adequately controlled by the proposed design?**
Question 7	**Do you agree that the same rules should apply to barristers or advocates, and the current special rules for barristers or advocates should be withdrawn?**
Question 8	**Is a statutory restriction on switching between the ordinary and cash basis needed? If so, how should the restriction operate?**
Question 9	**Do you have any other comments on the details of the proposed design of the cash basis?**
Question 10	**What are the pros and cons, as well as any other implications, of the cash basis? Please list these.**
Question 11	**Do you have any comments on the tax impact assessment for the cash basis in Chapter 5?**
Question 12	**Would a 3-tier banded rate or single fixed rate for business use of home strike the most appropriate balance between simplification and fairness?**

Question 13	**Are there any issues or transactions relevant to businesses eligible to use simplified expenses that have not been considered or addressed adequately?**
Question 14	**Do you have any other comments on the details of the proposals for simplified expenses?**
Question 15	**What are the pros and cons, as well as any other implications, of simplified expenses? Please list these.**
Question 16	**Do you have any comments on the tax impact assessment for simplified expenses in Chapter 5?**

7. The Consultation Process

This consultation is being conducted in line with the Tax Consultation Framework. There are 5 stages to tax policy development:

Stage 1 Setting out objectives and identifying options.

Stage 2 Determining the best option and developing a framework for implementation including detailed policy design.

Stage 3 Drafting legislation to effect the proposed change.

Stage 4 Implementing and monitoring the change.

Stage 5 Reviewing and evaluating the change.

This consultation is taking place during stage 2 of the process. The purpose of the consultation is to seek views on the detailed policy design and a framework for implementation of a specific proposal, rather than to seek views on alternative proposals.

How to respond

Please respond by 22 June 2012 to

Hasmukh Haria
HM Revenue & Customs, Room 3C/17, 100 Parliament Street, London SW1A 2BQ |
Email hasmukh.haria@hmrc.gsi.gov.uk
Tel 020 7147 2544

Fax 020 7147 2639

For enquiries please contact

Hasmukh Haria
HM Revenue & Customs, Room 3C/17, 100 Parliament Street, London SW1A 2BQ |
Email hasmukh.haria@hmrc.gsi.gov.uk
Tel 020 7147 2544

A summary of the questions in this consultation is included at chapter 6

Paper copies of this document or copies in Welsh and alternative formats (large print, audio and Braille) may be obtained free of charge from the above address. This document can also be accessed from the HMRC Internet site at http://www.hmrc.gov.uk/consultations/index.htm. All responses will be acknowledged, but it will not be possible to give substantive replies to individual representations.

When responding please say if you are a business, individual or representative body. In the case of representative bodies please provide information on the number and nature of people you represent.

Confidentiality

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentially can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Revenue and Customs (HMRC).

The Consultation Code of Practice

This consultation is being conducted in accordance with the Code of Practice on Consultation. A copy of the Code of Practice criteria and a contact for any comments on the consultation process can be found in Annex D.

Annex A: Standard mileage rate for business use of cars

Background

8.1 Under current legislation small businesses can claim motoring expenses on the basis of actual running costs, and relief for capital expenditure is available through Capital Allowances rules.

8.2 This necessitates the maintenance of detailed records of expenditure actually incurred. Revenue expenditure that is generally claimed as a motoring expense includes:

- Fuel
- Repairs
- Insurance
- Vehicle excise duty
- MOT.

8.3 If a motor vehicle is used for both business and private purposes then it is necessary for revenue costs to be apportioned to reflect the level of private usage, and similarly for Capital Allowances purposes a private use adjustment will be appropriate. This constitutes an administrative burden on the taxpayer.

8.4 Currently, there is a non-statutory mileage rate scheme which it is proposed to withdraw and replace with statutory rules.

Proposed Simplification

8.5 **The proposed rates are:**

- **Cars - 45p per mile for first 10,000 miles, 25p per mile thereafter**
- **Motor cycles – 24p per mile.**

8.6 **In the cash basis it is proposed that other types of motor vehicle (e.g. vans) can be treated in the same way as other plant or machinery, or the fixed mileage rate allowance can be used in the same way as for cars. All motor vehicles of this type must be treated in the same manner.**

8.7 On leaving the cash basis the exit treatment for these assets will depend on the method used within the regime. Where mileage rate is claimed for motor vehicles while using the cash basis, this method will continue to apply on exit from the regime.

8.8 Where the mileage rate scheme is used, no deduction may be made for the following expenses:

- Purchase costs
- Fuel
- Vehicle excise duty
- MOT
- Insurance
- Repairs
- Finance costs (including loan interest, hire purchase costs and finance lease costs).

8.9 No capital allowances may be claimed on any motor vehicle on which the mileage rate basis is used.

8.10 Under the mileage rate basis, it will not be necessary for businesses to maintain many of the records that they are currently required to do under the accruals basis, although a record of the number of business miles undertaken per year will still need to be maintained, in order to calculate the appropriate allowance.

Application to those using the normal rules

8.11 For those taxpayers who do not use the cash basis, but who nevertheless wish to use the mileage rate there will be no further deduction for any unrelieved written down value for the motor vehicles concerned.

8.12 In order for a business to use the mileage rate it must use the mileage rate for all motor vehicles of the same type.

8.13 Treatment of motor vehicles may not be changed subsequently.

8.14 The mileage rate can only be used for other motor vehicles (e.g. vans) if no relief has previously been claimed, partially or in full, under Capital Allowances or Annual Investment Allowance.

Annex B: Flat Rate Expenses for business use of home

Background

9.1 The self-employed are currently entitled to a deduction for a proportion of certain costs where part of their home is used solely for business purposes. Therefore, if a part of the home is used simultaneously for both a business and non-business purpose, then no deduction is due.

9.2 Factors ordinarily taken into account when apportioning household expenses are:

- The proportion of the area of the home used exclusively for business purposes
- The usage of supplies such as gas, electricity and water
- The amount of time that the part of the home is used exclusively for business purposes as opposed to any other purpose.

9.3 Capital expenditure, such as improvements to property, is not allowable.

Proposed Simplification

9.4 **It is proposed that if a taxpayer satisfies the criteria (detailed below) to enable them to make a claim for business use of home, they will receive a flat rate allowance per month based on the amount of time the home is used undertaking core business activities.**

9.5 The allowance would substitute for actual costs. No additional deduction could therefore be made in respect of actual expenditure.

9.6 **A taxpayer would be able to claim a standard amount for business use of home, if they carry out core business activities at their home for at least 25 hours per month. Such activities may be undertaken by the taxpayer themselves or an employee of the taxpayer. If less than 25 hours per month is spent undertaking core business activities at home, no allowance could be claimed for that month.**

9.7 Core business activity is work that provides goods or services to customers, or seeks new business (e.g. sales and marketing).

9.8 The following activities would not qualify:

- Storage
- Being on call / available to undertake work.
- Preparation of annual accounts or cash income calculations, and tax returns

9.9 **If the qualifying criteria are met then the entitlement is to claim a flat rate deduction. The level of deduction would be based on the time spent undertaking the qualifying business activity as follows:**

- **25-50 hours/month Rate of £8/month**
- **51-100 hours /month Rate of £16/month**
- **101 or more hours/month Rate of £24/month.**

9.10 **As an alternative simpler method it is proposed that if the qualifying criteria are met then the entitlement, regardless of the extent of the use of home, would be to claim a flat rate deduction. It is proposed that this amount would be set at £16 per month.**

9.11 The proposal reflects that it is an onerous burden (for what is usually a relatively small deduction) to require a judgement to be made as to the proportion of household expenses that can be claimed, and to keep track of the relevant expenditure. This proposal would lead to a reduced burden on the taxpayer, as they would only need to record the number of hours spent on core business activities over the period in order to claim a deduction.

Annex C: Flat rate adjustment for personal use of business premises

Background

10.1 Small business operators who live on their business premises (e.g. premises liable to business rates) can find that significant elements of business and private purpose are met out of the same expenditure. The law only permits a deduction for expenditure incurred wholly and exclusively for the business purpose.

10.2 In order to minimise the administrative costs of establishing an appropriate level of non-business expenditure to exclude, there is a history of informal agreements being made with HMRC.

Proposed Simplification

10.3 It is proposed to withdraw any existing informal agreements with effect from 31 March 2013 and introduce a new standardised formula based adjustment. The proposed amounts that would be excluded from the total costs would be as follows:

- **Single person** — **Rate of £350/month**
- **2 Persons** — **Rate of £500/month**
- **More than 2 persons** — **Rate of £650/month.**

Annex D: The Code of Practice on Consultation

About the consultation process

This consultation is being conducted in accordance with the Code of Practice on Consultation.

The consultation criteria

1. When to consult - Formal consultation should take place at a stage when there is scope to influence the policy outcome.

2. Duration of consultation exercises - Consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.

3. Clarity of scope and impact - Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.

4. Accessibility of consultation exercise - Consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.

5. The burden of consultation - Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.

6. Responsiveness of consultation exercises - Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.

7. Capacity to consult - Officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

If you feel that this consultation does not satisfy these criteria, or if you have any complaints or comments about the process, please contact:

Amy Burgess, Consultation Coordinator, Better Regulation and Policy Team, H M Revenue & Customs, Room 3E13, 100 Parliament Street, London, SWA 2BQ

E-mail hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk

Annex E: Relevant (current) Government Legislation

Capital Allowances Act 2001

Income Tax (Earnings and Pensions) Act 2003

Income Tax (Trading and Other Income) Act 2005

Income Tax Act 2007