

The expansion of the cash basis (Lecture B1422 – 16.22 minutes)

In his Budget Speech on 15 March 2023, the Chancellor said that the Government would be consulting on expanding the cash basis of accounting for unincorporated businesses with trading income. This consultation ran until 7 June 2023 and detailed revisions to the scheme were announced in the Autumn Statement on 22 November 2023. The new measure, which only affects self-employed taxpayers and does not apply to companies, has been set out in Cl 16 and Sch 10 FB 2024.

The cash basis – a self-explanatory system – is a method which unincorporated businesses can use to calculate their taxable trading profits as an alternative to employing the traditional accruals approach.

Currently, a person has to elect under S25A ITTOIA 2005 to utilise the cash basis, normally by notifying HMRC as part of the self-assessment tax return procedure. Historically, the accruals basis has been the default method for calculating profits, with the cash basis representing an opt-in regime.

The latest provisions change all this so that, for 2024/25 onwards, the cash basis becomes the default method for calculating trading profits (new S24A ITTOIA 2005 (as inserted by Para 2 Sch 10 FB 2024)), unless:

- the trade is an excluded trade (see new S25B ITTOIA 2005 (as inserted by Para 11 Sch 10 FB 2024) which specifies seven conditions under any of which the trade will be regarded as 'excluded'); or
- an election is made under new S25C ITTOIA 2005 (as inserted by Para 5 Sch 10 FB 2024) for the profits of the trade to be calculated in accordance with generally accepted accounting practice (GAAP), ie. the traditional accruals approach.

A S25C ITTOIA 2005 election ceases to have effect in the tax year:

- in which the trade becomes an excluded trade; or
- when there is an election to use the cash basis.

A further election to use GAAP can always be made subsequent to that tax year.

Para 3 Sch 10 FB 2024 makes amendments to S25 ITTOIA 2005 to require GAAP to be used where the cash basis does not apply.

By virtue of Ss31A and 31B ITTOIA 2005, businesses are only able to participate in the cash basis if their turnover is £150,000 or less and they are generally forced to leave the regime where their turnover exceeds £300,000. Para 6 Sch 10 FB 2024 removes these turnover restrictions in their entirety. Thus, sole traders and partnerships of individuals of any size are able to use the cash basis.

Cash basis businesses cannot deduct more than £500 in interest costs from their taxable profits in any one year (Ss51A and 57B ITTOIA 2005).

This interest restriction has been removed by Para 7 Sch 10 FB 2024, allowing such businesses to deduct any amount of interest provided that it is incurred wholly and exclusively for the purposes of

the trade. The cash basis and accruals basis rules for interest deductions have therefore been aligned.

Cash basis users are also restricted in the loss relief from which they can benefit where trading losses have been incurred. Sideways loss relief and relief against capital gains are not permitted (S74E ITA 2007). Losses generated in a cash basis trade can only be carried forward and set against future profits from the same trade or alternatively used under the terminal loss relief rules when there is a permanent cessation of the trade. These restrictions have been abolished by Para 8(a) Sch 10 FB 2024. From 2024/25 onwards, cash basis losses can be set sideways against total income (or gains) of the same period or carried back to earlier years.

Para 8(b) Sch 10 FB 2024 amends S384B ITA 2007 to remove the restriction of relief for interest paid on a loan the purpose of which was to buy plant or machinery for use by a partnership or to buy an interest in a partnership where the firm uses the cash basis for its trade. The restriction remains where the partnership uses the cash basis for a *property* business.

These FB 2024 provisions represent a fundamental change which will create very different profit (and loss) figures for a large number of businesses currently using the accruals basis.

It will be interesting to see whether anti-avoidance legislation has to be brought in, given that wider usage of the cash basis will make it easier to manipulate the taxpayer's profits and losses than under the accruals basis.

Also, as one commentator has pointed out:

'This move has the potential to tackle one of the biggest stumbling blocks to the implementation of Making Tax Digital for income tax self-assessment by allowing taxpayers to turn the data they have readily to hand – bank statements – into the required quarterly reports rather than having to process accruals-based adjustments to make quarterly data and estimates more meaningful.'

Another consequence, which should not be overlooked, is that clients who operate the cash basis may, in time, decide that they no longer need professional assistance with their accounting and tax, although this is likely to take effect over a period of years.

Contributed by Robert Jamieson