



## Calculation of trade profits etc (cash basis) Clause 16 and Schedule 10

### Executive Summary

The removal of several restrictions in the cash basis rules is a simplification which may encourage more unincorporated businesses to use it. However, the cash basis will still not be suitable for all businesses, particularly larger and more complex ones. We are doubtful that removing the thresholds will encourage larger businesses to use it.

For small businesses, we are concerned that, in encouraging the cash basis, the benefits of the accruals basis in improving financial literacy for the small business owner may be diminished.

There is a lack of awareness of what the cash basis is, particularly amongst businesses that do not have an accountant. Making the cash basis the default could lead to businesses using it where it is not the best option for them. HMRC's guidance for the cash basis needs to be improved and updated.

HMRC need to be alive to the possibility that some taxpayers may try and abuse the rules once the restrictions are lifted.

### 1. Overview

- 1.1. The cash basis is a simplified regime for calculating taxable profits for unincorporated businesses with straightforward tax affairs, which was introduced in 2013. It allows businesses to calculate their taxable profit as the difference between income and expenditure when money is actually received or paid out, rather than in accordance with generally accepted accounting practice (GAAP (or accruals) accounting), provided certain criteria are satisfied.
- 1.2. The legislation makes the following changes to the cash basis<sup>1</sup> with effect from the tax year 2024/25. This follows a consultation that took place in 2023.
- 1.3. The turnover threshold for the cash basis will be removed so as to expand the regime to larger unincorporated businesses, allowing more businesses to continue to use or to choose

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<sup>1</sup> HMRC Policy Paper Expanding the Cash Basis – 22 November 2023

<https://www.gov.uk/government/publications/expanding-the-income-tax-cash-basis-for-self-employed-individuals-and-partnerships/expanding-the-cash-basis>

whether to use the cash basis. Currently, businesses are only able to join the cash basis if their cash basis turnover is less than £150,000 and must leave it where their turnover exceeds £300,000.

- 1.4. Setting the cash basis to be the default basis for eligible businesses to calculate taxable profits. Currently, GAAP is the default basis and businesses must elect to use the cash basis. This will be reversed, so that businesses must in future elect if they wish to use GAAP accounting.
- 1.5. Removing the interest restriction for businesses in the cash basis thereby allowing them to deduct any amount of interest as long as it is incurred wholly and exclusively for the purposes of the trade. Currently businesses which use the cash basis are unable to deduct more than £500 in interest costs per year.
- 1.6. Removing the restrictions on loss relief in the cash basis. This means that cash basis losses will be able to be set sideways against general income of the same period or carried back to earlier years. Currently, for businesses which use the cash basis, losses can only be carried forward and set against future profits from the same trade or used when the business stops trading.
- 1.7. These proposals have the potential to widen eligibility for the cash basis to almost every self-employed business (a few exceptions will remain).

## **CIOT comments**

### **2. Simplification**

- 2.1. We agree with HMRC that there are aspects of the current rules that can deter otherwise eligible businesses from using the cash basis, particularly the loan interest and loss relief restrictions. Removing some of the inherent complications and restrictions so as to simplify the rules is a welcome simplification which may encourage more businesses to use the cash basis. The current restrictions around loss relief and interest deductions undoubtedly influence some businesses' decision not to join the cash basis.
- 2.2. However, we temper that by noting that the cash basis will not be suitable for all businesses. This is because preparing accounts on a cash basis really only satisfies the need to report to HMRC, whereas reporting on an accruals basis (ie using GAAP accounting) serves several purposes, including accurately measuring profitability and providing evidence for loan applications. For many businesses this supersedes any simplification benefits from preparing accounts using the cash basis.
- 2.3. One of the benefits of the accruals basis is that it can help improve general financial literacy for the small business owner, including the need for budgeting and identifying and understanding the true profitability of their business. In encouraging the cash basis, the government are arguably encouraging weaker financial controls and worse financial literacy more generally.

- 2.4. We doubt that removing the thresholds will encourage larger businesses to use it because their affairs will be too complex. Most businesses in this population, due to their size, are also more likely to use a professional accountant to help prepare their financial statements so are not likely to consider it particularly complicated, or onerous, to use GAAP accounting.
- 2.5. Ultimately the cash basis, even an expanded and less restrictive version, is still likely to be suitable only for small businesses with very straightforward financial affairs. In other words, unrepresented taxpayers, with no employees, and without, or with very low, levels of stock, debtors, creditors and fixed assets.

### **3. Making the cash basis the default**

- 3.1. We are concerned that HMRC are making the cash basis the default without investigating and thereby fully understanding why eligible businesses are not currently using it. We think it is likely that there is a significant lack of understanding and awareness of the cash basis particularly amongst businesses that do not have an accountant. We also suspect that significant numbers of unrepresented businesses are already using the cash basis without realising they are doing so or ticking the box on their tax return confirming that they are doing so.
- 3.2. We are concerned that making the cash basis the default could lead to some businesses using it 'by accident' even though the accruals basis may be more suitable for their needs.
- 3.3. To help address this, it is worth asking whether HMRC would consider changing the Self Assessment (SA) tax return so as to provide two alternative boxes (one for 'cash basis' and one for 'accruals basis') and making it mandatory to tick one or the other. This would require the taxpayer to make a positive decision between the two options and encourage them to think more carefully about which option would be more beneficial for them to use. It would be essential to provide guidance about the two accounting bases in the tax return explanatory notes, on GOV.UK and via the use of nudges and prompts in the SA return software. Some people might be unable to make that decision without professional help.
- 3.4. If there is to be only a requirement to tick one box or the other, it is important that the taxpayer's online tax return should be pre-populated with a note to say which choice the person made the previous year to help avoid the problem identified during the consultation of people switching to and from the cash basis (probably inadvertently) – a problem which is likely to continue regardless of whether it is made the default – and could therefore lead to inaccuracies in returns.

### **4. Guidance**

- 4.1. Changes to the current rules must go hand-in-hand with improving and updating the guidance for the cash basis on GOV.UK, particularly since it will now be the default basis, and we welcome HMRC's commitment at Autumn Statement to improving their guidance.

Better guidance may help increase understanding and awareness and reduce errors - particularly amongst businesses which do not have an accountant - and lead to more businesses taking advantage of the simplifications offered by using the cash basis where it is appropriate for them to do so.

- 4.2. It is important that guidance is updated to reflect modern ways of working, for example that many small businesses now trade online or operate via online digital platforms. Help and support for businesses transitioning in and out of the cash basis will also be essential as calculating the transitional adjustments required is not necessarily straightforward.

## **5. Scope for abuse**

- 5.1. It is possible that a minority of taxpayers will see the relaxation of restrictions as an opportunity to take advantage of the rules to reduce their tax liabilities. This may involve taking advantage of timing differences such as accelerating cash payments into earlier accounting periods or deferring cash income, or something more insidious. It will be important that HMRC are alive to the possibility of more serious abuse so that they can react appropriately, when and if necessary.
- 5.2. We set out our comments on this measure in more detail in our response to HMRC's consultation document<sup>2</sup>.

## **6. The Chartered Institute of Taxation**

- 6.1. The CIOT is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.
- 6.2. The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

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<sup>2</sup> Expanding the cash basis for the self-employed – HMRC consultation - CIOT Response  
<https://assets-eu-01.kc-usercontent.com/220a4c02-94bf-019b-9bac-51cdc7bf0d99/db5798ce-b34f-4401-bcd8-915693e3d721/230606%20Expanding%20the%20cash%20basis%20for%20the%20self%20employed%20-%20CIOT%20response.pdf>

## CIOT Representation - Finance Bill 2023-24 – Clause 16 and Schedule 10

- 6.3. The CIOT's 19,000 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

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The Chartered Institute of Taxation  
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