

**EXPLANATORY MEMORANDUM TO**  
**THE INCOME TAX (RELEVANT MAXIMUM FOR CALCULATING TRADE**  
**PROFITS ON THE CASH BASIS) ORDER 2017**

**2017 No. 293**

**1. Introduction**

- 1.1 This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs ("HMRC") on behalf of HM Treasury and is laid before the House of Commons by Command of Her Majesty.

**2. Purpose of the instrument**

- 2.1 This instrument makes amendments to Section 31B of the Income Tax (Trading and Other Income) Act 2005 ("ITTOIA 2005"), in order to set the "relevant maximum" threshold at which an individual can elect to calculate trade profits using cash basis accounting. The change is to increase the cash basis threshold to a fixed amount of £150,000 and the exit threshold to twice the entry threshold. The cash basis thresholds for universal credit ("UC") claimants (for both entry and exit) is set at £300,000.

**3. Matters of special interest to Parliament**

*Matters of special interest to the Select Committee on Statutory Instruments*

- 3.1 None.

*Other matters of interest to the House of Commons*

- 3.2 As this instrument is subject to negative resolution procedure and has not been prayed against, consideration as to whether there are other matters of interest to the House of Commons does not arise at this stage.

**4. Legislative Context**

- 4.1 The ability for individuals to elect to calculate trade profits on a cash basis was introduced by Schedule 4 to the Finance Act 2013. The current legislation is within Part 2 of ITTOIA 2005. Section 25A allows an individual to elect to calculate profits using cash basis accounting and section 31A sets out the conditions to be met in order for that election to be made. Sections 31(A) and 31(B) do not apply to limited liability partnerships and partnerships where there is a member who is not an individual, or the other excluded persons listed in section 31C.
- 4.2 Section 31B sets out the "relevant maximum" and the circumstances in which it applies. Individuals or partnerships with trade income below the VAT threshold (currently £83,000) can use cash basis accounting for calculating their taxable profits for a tax year. UC claimants have a higher relevant maximum of twice the VAT threshold (currently £166,000). But where receipts during the previous tax year exceeded twice the entry threshold, cash basis accounting cannot be used unless receipts in the current year are below the relevant maximum (the exit threshold of £166,000 also applies to UC claimants).

## **5. Extent and Territorial Application**

- 5.1 The extent of this instrument is the United Kingdom.
- 5.2 The territorial application of this instrument is the United Kingdom

## **6. European Convention on Human Rights**

- 6.1 The Financial Secretary to the Treasury has made the following statement regarding Human Rights:

“In my view the provisions of the Income Tax (Relevant Maximum for Calculating Trade Profits on the Cash Basis) Order 2017 are compatible with the Convention rights.”

## **7. Policy background**

### *What is being done and why*

- 7.1 Cash basis accounting was implemented from April 2013. It is a simplified method of calculating taxable profits for unincorporated trading businesses. It operates by calculating taxable profits on the basis of income received less any expenses in any period. The cash basis is targeted at unincorporated businesses with straightforward tax affairs. Businesses eligible for the cash basis are not required to use Generally Accepted Accounting Practice (GAAP) for calculating their taxable profits. Over one million businesses are currently using the cash basis.
- 7.2 Increasing the cash basis threshold will give more businesses access to simplified reporting, making it easier for them to provide information and get a real-time overview of their tax affairs. The cash basis reduces reporting burdens on business and facilitates the introduction of making tax digital (MTD). MTD is an accessible tax system fit for the digital age. It is a simple, secure and personalised digital tax account for businesses and individuals.
- 7.3 Over one million businesses already benefit from cash basis accounting and increasing the turnover threshold will allow more to be eligible. Increase to the turnover threshold will allow around 135,000 more businesses to become eligible for cash basis accounting.
- 7.4 The current cash basis entry and exit thresholds of £83,000 and £166,000 respectively are linked to the VAT threshold. The changes to increase the entry and exit thresholds to a fixed amount of £150,000 and £300,000 respectively will break the link to the VAT threshold. Reference to the VAT threshold is retained to ensure that the new cash basis thresholds do not fall below the VAT threshold. To ensure that businesses are not disadvantaged should the VAT threshold ever increase significantly, the cash basis thresholds will move up to match the movement in the VAT threshold.

### *Consolidation*

- 7.5 There are no current plans to consolidate the amendments made by this instrument.

## **8. Consultation outcome**

- 8.1 HMRC consulted formally with unincorporated businesses, their advisers and representative bodies as part of the simplifying tax for unincorporated businesses

consultation which was open from 15 August 2016 until 7 November 2016. During that time, HMRC also hosted webinars and conducted an online survey. There were 596 responses to the questions on the increase to the cash basis threshold. The majority of respondents to the consultations were accountants. Some were professional bodies and very few were direct representations from self-employed traders.

- 8.2 Many of the accountants do not believe cash basis accounting is a true reflection of financial performance for a more complex business, but they agreed that it can provide a simple way of reporting to HMRC. The majority of the respondents agreed with an increase to the cash basis threshold.
- 8.3 The government plans to increase the cash basis entry threshold to £150,000, an option that was explored in the consultation. The cash basis exit threshold will continue to be set at twice the entry threshold, so will increase to £300,000. The entry and exit threshold for UC claimants will continue to be set at twice the entry threshold for non-UC claimants, so will increase to £300,000.

## **9. Guidance**

- 9.1 Guidance will be updated to reflect the changes.

## **10. Impact**

- 10.1 The impact on business, charities or voluntary bodies is a further reduction of administrative burden for more small unincorporated businesses. It increases the number of eligible businesses which can make use of a simplified method for calculating their taxable profits.
- 10.2 There is no impact on the public sector.
- 10.3 A Tax Information and Impact Note covering this instrument was published on 31st January 2017 alongside the draft instrument. This has been updated as a result of changes to the impacts as a result of this instrument and is available on the website at <https://www.gov.uk/government/collections/tax-information-and-impact-notes-tiins>.

## **11. Regulating small business**

- 11.1 The legislation applies to activities that are undertaken by small businesses. The proposed changes will reduce administrative burden for unincorporated small businesses.

## **12. Monitoring & review**

- 12.1 Ongoing monitoring of the use of the cash basis will take place through information collected on tax returns and will be used to assess whether the amended thresholds are achieving the policy objectives.

## **13. Contact**

- 13.1 Toyin Olaiya at the HM Revenue & Customs email: [oluwatoyin.olaiya@hmrc.gsi.gov.uk](mailto:oluwatoyin.olaiya@hmrc.gsi.gov.uk) can answer any queries regarding the instrument.