



Research report

Cash Basis & Simplified Expenses

Research to evaluate guidance on Cash Basis and Simplified Expenses

Business Customer & Strategy (BC&S)
March 2013

Cash Basis and Simplified Expenses

About Business Customer and Strategy (BC&S)

Business Customer and Strategy is part of Business Tax.

The goal of BC&S is to maximise Business Customer compliance for HMRC at best cost for both HMRC and the customer. This is done by developing business tax strategies through customer understanding, working with teams in HMRC and across government departments.

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Research requirement (background to the project)

Research was required to test proposed new guidance for two small business schemes – cash basis and simplified expenses – that HMRC planned to introduce from the 2013/14 tax year. The research sought to understand whether eligible businesses found the guidance clear and helpful and what action it would encourage them to take.

The feedback from this user testing was used by HMRC to finalise the guidance published on GOV.UK to support the launch of cash basis and simplified expenses in April 2013.

When the research took place

An initial round of user testing was conducted in mid-January 2013. A second round of testing was conducted in March 2013.

Who did the work (research agency)

The research was conducted by Opinion Leader, a market research agency based in London.

Method, Data and Tools used, Sample

Four focus groups, each lasting two hours, were conducted in the initial research phase and six focus groups, each lasting two hours, were conducted in the second research phase. To meet HMRC's user-testing requirements, all businesses recruited to the research were unincorporated – i.e. self-employed, simple trade businesses not incorporated at Companies House – and none were meant to employ an accountant.

The sample was divided into two subsets: new businesses and established businesses. New businesses were defined as those which had been operating for less than a year, and so had not submitted a Self Assessment return to HMRC. Established businesses were defined as those which had been operating for around three years and so had submitted two or three Self Assessment returns to HMRC.

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Main Findings

Overview

Customer testing of the initial HMRC iteration of the guidance in January 2013 showed that several improvements were needed. Customers' responses clearly indicated the initial guidance:

- Was too long and wordy.
- Did not clearly define the customer benefits of cash basis and simplified expenses.
- Confused customers when mentioning Universal Credit.
- Required a simpler, more user-friendly format including greater use of visual representations such as flow charts, etc.

Building on this feedback, HMRC worked with the Government Digital Service on revised guidance for cash basis and simplified expenses, to be published on GOV.UK. This was tested at the end of March 2013, and customers found it to be much clearer and more useful than previous iterations. The simple text format and easy-to-understand language were appreciated and, overall, both pieces of guidance compared well with people's experience and expectations of the guidance normally received from HMRC. The simplified expenses guidance was regarded as especially clear, with a welcome use of tables, calculations and examples.

A minority of participants across the groups expressed concern that having to choose between accounting methods would increase confusion and drive telephone calls to HMRC, regardless of how clear the guidance was. An overview enabling businesses to identify the most appropriate method of record-keeping was felt to be needed as the tested guidance on business records did not provide this. In particular, greater clarity was needed about the choices open to businesses when completing their Self Assessment returns (i.e. traditional (accruals) accounting vs. cash basis; and apportionment of actual business and private expenditure vs. simplified expense flat rates). The manner in which the tested draft of record keeping guidance separated the options into three accounting methods (traditional accounting methods, cash basis, simplified expenses) did not communicate this effectively.

Participants were keen that HMRC inform them of the changes (i.e. the introduction of the new accounting methods) as soon as possible so that they could start keeping records in an appropriate fashion.

The enthusiasm of customers for on-line support tools, from monthly record keeping to EOY/return calculations, was evident and a common theme at a number of the sessions.

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Cash Basis Guidance

The guidance was felt to be clear on the kinds of business the cash basis applied, and did not apply to and on the start date for its use. In half of the groups, participants commented that the guidance was better than existing examples of HMRC guidance that they had read, as it was simply and cleanly laid out, used laymen's terms and was largely jargon-free. In particular, the simple text format was liked and there were very few calls for any diagrammatic representation or for the use of case studies.

Most established business customers understood the cash basis guidance and could summarise it accurately. All of the established businesses that had been recruited were already using a form of cash-based accounting and understood that the cash basis proposals were similar to or the same as this. Although some struggled to see why a new name ('cash basis') was needed and why new guidance had to be issued, others could understand that this was a formalisation of existing, informal, procedures.

Established businesses could not always see why the guidance was being positioned as something different from previous accounting methods, given that they were already using a form of cash-based accounting. They suggested an upfront statement that cash basis formalised a cash-based accounting approach that businesses might already be using.

New businesses found the cash basis guidance more difficult to understand as they had not submitted a Self Assessment return before and had only limited knowledge of current accounting methods. However, having read the guidance, most new businesses understood that cash basis was a new approach to Self Assessment that was based on money received and paid out in the tax year, rather than money invoiced and expenses incurred.

Simplified Expenses Guidance

Both new and established businesses found the simplified expenses guidance clear and straightforward. The guidance was seen as helpful, particularly in its provision of tables and examples. Where objections to the guidance were raised these tended to relate less to the quality of the guidance and more to the level of rates offered for each of the expenses, especially for 'business use of your home' which was perceived to be particularly low and unfavourable to businesses.

Established businesses felt that it would be a relatively quick, simple task to compare the flat-rate and actuals accounting methods and calculate which was most beneficial. However, since businesses would be keeping records of their full expenses, not all regarded the flat-rate option as a great time saver in itself

In one of the six focus groups (group four, established businesses), a few participants were confused as to whether simplified expenses could be used in a piecemeal manner or not. For example, if a business chose to use simplified expenses for vehicles, did it then have to do so for business use of the home and private use of business premises as well? The other

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groups did not experience this confusion but it may be worth HMRC clarifying that simplified expenses can be used separately from one another in the final guidance.

Business Records if you're Self-Employed

Overall, the tested version of the business records guidance was more problematic than the sections for cash basis or simplified expenses. It was seen as confusing and repetitive, and participants found it difficult to pick out the information that was relevant to them.

The guidance was text-heavy and the inconsistent use of terminology made it difficult for participants to understand. Participants did not always identify the distinction being made between traditional (accruals) accounting, cash basis and simplified expenses and it was not clear from the guidance what choices participants could make (i.e. traditional (accruals) accounting vs.cash basis; and normal accounting vs. simplified expenses) when completing their self-assessment returns.

SA103 Self-Employment (Short) Return Questions

Participants were provided a mock-up of a Self-Assessment SA103 tax return, and shown a new question (Question 8 on the form) which asked them to indicate whether they had used the cash basis to calculate their income and expenses in that year. None of the groups (including the groups of established businesses who had previously submitted returns) indicated a concern if a new question and tick-box was added to future years' Self Assessment returns.

To test the wording of the proposed new Question 8, HMRC obtained participants' reactions to four alternative versions:

- **Option A:** If you used the cash basis to record your income and expenses put 'X' in the box – *read the notes*
- **Option B:** If you used the simpler income tax cash basis to record your income and expenses put 'X' in the box – *read the notes*
- **Option C:** If your taxable profit is based on the money you actually received and paid out put 'X' in the box – *read the notes*
- **Option D:** If you calculated your taxable profit on the cash basis put 'X' in the box – *read the notes*

Whilst there was no overwhelming preference, overall, Option A and Option C were received more positively than other options. Preferences were determined by type of business and by the order in which the options were shown:

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• **Type of business**

- > Existing businesses preferred Question C because they already understood the term ‘taxable profit’ and the description in this question therefore used language that was familiar to them, making it relatively easy to understand.
- > New businesses tended to prefer Question A because they did not have a pre-existing understanding of ‘taxable profit’ and preferred ‘cash basis’ as this was a more consistent use of terminology.

• **Test ordering**

- > The SA return question options were tested both before and after participants were given an opportunity to read the accompanying guidance. This tried to reflect the different ways customers may come to the Self Assessment return question from next year onwards, as some will have read the guidance beforehand, and others not. An order effect was observed in the research.
- > Question A received more support amongst both new and established businesses where it was shown after the cash basis (and other) guidance. In these cases, businesses could see the value of consistent terminology allowing them to relate the guidance to the self-employment question.
- > Question C received most support where it was shown before the guidance. ‘Taxable profit’ was thought to be easier to understand than ‘cash basis’ where participants had not been exposed to the cash basis guidance beforehand.

Given that cash basis introduced something new to the Self Assessment return form and introduced a new focus on cash-basis accounting, few participants felt confident answering Question 8 in the testing environment based on the question alone. The majority of participants said they would read the accompanying notes (which will be published with the Self Assessment return) to determine whether they would be able to answer this question by themselves or would need to contact HMRC, a friend or an accountant for help.

• **Key findings**

Key findings	HMRC response
An overview enabling businesses to identify the most appropriate method for them was seen to be needed. In particular, greater clarity was needed about the actual choices open to businesses when completing their Self-Assessment returns.	The published GOV.UK guidance pages contain an overview setting out the main eligibility criteria, and guidance for customers on circumstances in which adopting the cash basis may not be appropriate.
Participants were anxious that HMRC inform them of the changes (i.e. the	GOV.UK guidance has been available since the beginning of the 2013/14 tax year. In April 2013,

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<p>introduction of the new accounting methods) as soon as possible so that they could start keeping records in an appropriate fashion.</p>	<p>HMRC publicised the changes via the HMRC website and through its Key Messages and Agent Update publications. HMRC has produced and disseminated education and support tools to explain the changes to customers, including webinars and a YouTube video and is working with intermediaries to raise awareness of the changes with the widest possible cross-section of eligible businesses.</p>
<p>A few participants were confused as to whether simplified expenses could be used in a piecemeal manner or not. For example, if a business chose to use simplified expenses for vehicles, did it then have to do so for business use of the home and private use of business premises as well? It may be worth HMRC clarifying that simplified expenses can be used separately from one another in the final guidance.</p>	<p>The overview page of the published guidance on GOV.UK makes clear that simplified expenses can be used for any or all of the three types of business expenses.</p>
<p>Overall, the tested version of the business records guidance was more problematic than the sections for cash basis or simplified expenses. It was seen as confusing and repetitive, and participants found it difficult to pick out the information that was relevant to them.</p>	<p>The published GOV.UK guidance has been reworked to set out more clearly the differences in record-keeping requirements for those using traditional (accruals-based) accounting and those using cash basis and/or simplified expenses.</p>
<p>None of the groups indicated a concern if a new question and tick-box was added to future years' Self-Assessment returns. The majority of participants said they would read the accompanying notes (which will be published with the SA return) to determine whether they would be able to answer this question by themselves or would need to contact HMRC, a friend or an accountant for help.</p>	<p>HMRC plans to provide notes to accompany the SA Return to support businesses in completing the return correctly.</p>