Clause 1: Cash basis: treatment of capital

Summary

1. This clause replaces a general prohibition on deductions for capital expenditure in calculating taxable profits using the cash basis, with a more focused and limited prohibition on deductions for certain specified capital expenditure.

Details of the clause

2. Subsection (1) amends the Income Tax (Trading and Other Income) Act (ITTOIA) 2005 and replaces section 33A Cash basis: capital expenditure.

3. New Section 33A(1) provides for the clause to have effect for calculating taxable trading profits using the cash basis.

4. New Section 33A(2) prevents any deduction for capital expenditure to acquire or dispose of a business.

5. New Section 33A(3) prevents any deduction for capital expenditure in connection with the undertaking of education or training.

6. New Section 33A(4) prevents any deduction for capital expenditure on the provision, alteration, or disposal of certain types of assets: land, financial assets, "non-qualifying" intangible assets, cars, and assets that are not "depreciating assets" or which are not for use in the trade.

7. New Section 33A(5) limits the application of subsection 4 to land so that it does not prevent a deduction for the provision and installation of a depreciating property fixture.

8. New Section 33A(6) provides that an asset should be regarded as a "depreciating asset" unless it is expected to have a useful life of over 20 years and to still be worth more than ten percent of its original value.

9. New Section 33A(7) provides that the useful life of an asset should be regarded as ending when the asset is of no use as a business asset.

10. New Section 33A(8) provides a definition of "intangible asset", for the purposes of the clause.

11. New Section 33A(9) provides that an intangible asset should be regarded as "non-qualifying" unless the asset expires within 20 years of expenditure being incurred.

12. New Section 33A(10) provides that an intangible asset should be regarded as "non-qualifying" if there is a right to renew or replace it so that an asset can continue to exist more than 20 years after expenditure is incurred.

13. New Section 33A(11) provides that an intangible asset should also be regarded as "non-qualifying" if it is a license or other right in respect of an intangible asset which the taxpayer already holds.

14. New Section 33A(12) provides a definition of "financial asset", for the purposes of the clause.
15. New Section 33A(13) ensures that the provisions in the clause apply to abortive capital expenditure.
16. New Section 33A(14) provides definitions of various terms used in the clause.
17. Subsection 2 confirms the date from which subsection (1) shall take effect, namely for the tax year 2017-18 and subsequent tax years.
18. Subsection 3 confirms the transitional arrangements for the legislation. This sets out that for tax year 2017-18, if any person were to be disadvantaged by the new rules when compared to the old rules, then the old rules apply in calculating the profits of that trade, profession or vocation for that tax year.

Background note

19. This measure provides a simple, workable definition in order to simplify the rules for allowable deductions within the cash basis.
20. Current tax rules for calculation of profits under the cash basis do not allow a deduction for expenditure of a capital mature unless such expenditure would qualify for plant and machinery capital allowances under the ordinary tax rules.
21. This means that taxpayers still need to consider firstly whether an item of expenditure is capital in nature, and secondly whether the expenditure would qualify for capital allowances.
22. This measure replaces the general disallowance of capital expenditure with a more limited disallowance of capital expenditure incurred in relation to assets which are not used up in the business over a limited period.
23. At Budget 2016, the Government announced that it would explore options to simplify the tax rules for businesses, self-employed people and landlords.
24. A consultation covering four discrete areas of simplifying tax paid by unincorporated businesses, including reforming the capital/revenue divide in the cash basis and simplified cash basis for unincorporated property businesses, was published on 15 August 2016 and ran until 7 November 2016. The consultations were published as part of a collection on Making Tax Digital.
25. If you have any questions about this change, or comments on the legislation, please contact Jack Banks on 03000 593674 (email: john.banks1@hmrc.gsi.gov.uk)