

Using the cash basis – is it for you?

The cash basis is a simpler way of working out taxable profits compared to the traditional accruals method. The cash basis takes account only of money in and money out – income is recognised when received and expenses are recognised when paid. By contrast, the accruals basis matches income and expenditure to the period to which it relates. Consequently, where the cash basis is used there is no need to recognise debtors, creditors, prepayments and accruals, as is the case under the accruals basis.

Example

Ben is a self-employed plumber. He prepares accounts to 31 March each year. On 28 March 2019 he fits a new shower, invoicing the customer £600 on 29 March 2019. The customer pays the bill on 7 April 2019.

He purchased the shower for £400 on 25 March 2019, receiving an invoice from his supplier dated the same date. He pays the bill on 8 April 2019 after he has been paid by the customer.

On the cash basis, the income of £600 and expenditure of £400 fall in the year to 31 March 2020 – they are recognised, respectively, when received and paid (in April 2019). By contrast, under the accruals basis, the income and expenditure falls into the year to 31 March 2019 as this is when the work was done and invoiced.

Who can use the cash basis?

The cash basis is available to small self-employed businesses (such as sole traders and partnerships) whose turnover computed on the cash basis is less than £150,000. Once a trader has elected to use the cash basis, they can continue to do so until their turnover exceeds £300,000. These limits are doubled for universal credit claimants.

Limited companies and limited liability partnerships cannot use the cash basis.

Advantages of the cash basis

The main advantage of the cash basis is its simplicity – there are no complicated accounting concepts to get to grips with. Because income is not recognised until it is received, it means that tax is not payable for a period on money that was not actually received in that period. This also provides automatic relief for bad debts without having to claim it.

Not for everyone

Despite the advantages associated with its simplicity, the cash basis is not for everyone. The cash basis may not be the right basis for you if:

- you want to claim a deduction for bank interest or charges of more than £500 (a £500 cap applies under the cash basis);
- your business is more complex, for example, you hold high levels of stock;
- your need to obtain finance – banks and other institutions often ask for accounts prepared on the accruals basis;
- you want to claim sideways loss relief (i.e. set a trading loss against your other income) – this is not permitted under the cash basis.

Need to elect

If the cash basis is for you, you need to elect for it to apply by ticking the relevant box in your self-assessment return.

