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VAT - Cash Accounting

Cash accounting enables a business to account for and pay VAT on the basis of cash received and paid, rather than on the basis of invoices issued and received.

Advantages and Disadvantages of the Scheme

The advantages of the scheme are as follows:

- Output tax on sales income is not due until the business receives payment of its sales invoices. If customers pay promptly, the advantage will be limited. Even so, the gain may be material.
- There is automatic VAT bad debt relief because, if no payment is received, no output tax is due.
- Most smaller businesses find it easier to think in terms of cash flows in and out of their business than invoiced amounts.

The potential disadvantages are as follows:

- There is no input tax recovery until payment of suppliers' invoices is made.
- The scheme will not be beneficial for net repayment businesses - for example, a business just starting up, which has substantial initial expenditure on equipment, stocks etc. so that input tax exceeds output tax, should normally delay joining the scheme. That way, it can make use of the accruals basis to recover the initial input tax on the basis of invoices received, as opposed to payments made.

Key Rules

A business can join the scheme if it has reasonable grounds for believing that taxable turnover in the next 12 months will not exceed £1,350,000 and provided that it:

- is up to date with VAT returns
- has paid over all VAT due or has agreed with HMRC a basis for settling any outstanding amount in instalments
- has not in the previous year been convicted of any VAT offences.

All standard and zero-rated supplies count towards the £1,350,000 threshold except anticipated sales of capital assets previously used within the business. Exempt supplies are excluded from the calculation.

When a business joins the scheme, it must be careful not to account again for VAT on any amounts already dealt with previously on the basis of invoices issued and received.

A business can start using the scheme without informing HMRC.

The cash accounting scheme does not cover:

- goods bought or sold under lease or hire-purchase agreements
- goods bought or sold under credit sale or conditional sale agreements
- supplies invoiced where full payment is not due within six months
- supplies invoiced in advance of delivering the goods or performing the services.

Once annual taxable turnover exceeds £1,600,000 the business must leave the scheme immediately.

On leaving the scheme, in principle VAT becomes due on all supplies on which it has not already been accounted for. Unclaimed input tax on invoices received can be offset against the output tax. However in order to smooth the transition from cash accounting to accruals accounting HMRC allows a period whereby all VAT that is outstanding at the date of leaving the scheme can still be accounted for on a cash basis for a further six months after leaving the scheme.

Accounting for VAT

Output tax must be accounted for when payment is received. There are specific rules for different types of payment:

Cheque
Treated as received on the date the cheque is received or if later, the date on the cheque. If the cheque is not honoured an adjustment can be made.

Credit/debit card
Treated as received/paid on the date of the sales voucher.

Standing order/direct debits
Treated as received/paid on the day the bank account is credited.

Part payments
VAT must be accounted for on all receipts/payments even where they are part payments. Part payments are allocated to invoices in date order (earliest first) and any part payment of an invoice allocated to VAT by making a fair and reasonable apportionment.

Records

Under the cash accounting scheme the prime record will be a cash book that summarises all payments made and received with a separate column for VAT. The payments need to be clearly cross-referenced to the appropriate purchase/sales invoice.

In addition, the normal requirements regarding copies of VAT invoices and evidence of input tax apply.

How we can help

We can advise on whether the cash accounting scheme would be suitable for your business.

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