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Small businesses only need to pay tax on money received; outstanding amounts can be ignored for tax purposes

Cash basis threshold increased

The cash basis is a simpler way for smaller businesses to work out their taxable profit. Under the cash basis, profit is calculated by reference to cash in and cash out, rather than by reference to income earned in the period and expenditure incurred, as is the case under the traditional accruals basis.

Prior to 6 April 2017, the cash basis was only open to sole traders and unincorporated businesses with a turnover below the VAT registration threshold (which was set at £83,000 from 1 April 2016 and increased to £85,000 from 1 April 2017).

However, in preparation for the introduction of Making Tax Digital, under which businesses will be required to maintain records digitally and to provide digital updates to HMRC quarterly, the cash basis threshold has been increased. Availability of the cash basis is also extended to unincorporated landlords from 2017/18 onwards.

New look cash basis

From 6 April 2017, the entry threshold for the cash basis is increased to £150,000. Once using the cash basis, businesses can remain in it until their turnover exceeds the exit threshold, set at double the entry threshold. Thus, the exit threshold is £300,000 from 6 April 2017.

From 6 April 2017, the cash basis also becomes the default accounting basis for unincorporated businesses with rental income of £150,000 or less. Such businesses can still use the accrual basis if they prefer – but will need to elect to do so.

Capital expenditure

Simplified rules for treating capital expenditure under the cash basis are also introduced from 6 April 2017. Instead of the general prohibition on capital expenditure that applied prior to that date, the new rules only prohibit the deduction of certain items, namely:

- capital items incurred in connection with the acquisition or disposal of a business or part of a business;
- any asset not acquired or created for use on a continuing basis in the trade;
- a car;
- land;
- certain intangible assets, including education or training; and
- financial assets.

Capital expenditure that does not fall into the above categories can be deducted as for revenue expenditure.

Is it for me?

The cash basis will suit many small businesses, but it is not for all businesses. This may be the case if the business has high stock levels or has losses that would be beneficial to offset against other businesses. On the plus side, tax is only payable on money that has actually been received by the year end.

Partner note: ITTOIA 2005, s. 33A, 95A, 96A; 2017 Finance Bill, cl. 19 and Sch. 5.

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