Example&Co.

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Using cash basis accounting

There are important changes to the rules on cash basis accounting, aimed at driving many more businesses into using the scheme.

As a result, most unincorporated businesses will need to decide what to do next. We look at the factors involved, and what moving to the cash basis might mean for you.

In outline

Change from 6 April 2024 makes cash basis the default method of calculating profits for trading income for Income Tax, rather than the traditional accruals basis. The move turns the previous position upside down. Businesses now have to opt out of cash basis, whereas previously, they had to opt in.

In a second major move, the cash basis regime itself has been given a considerable makeover. Key restrictions under the old regime have been lifted, making cash basis more viable for a wider range of businesses.

For the avoidance of confusion: the cash basis rules used by landlords, and the cash accounting scheme for VAT are separate regimes, and there are no changes to either of these.

Your choices

Essentially, your business will now need to use the cash basis, unless you opt out. Note, though, that companies cannot use cash basis, and some businesses are excluded. Some of the main exclusions are:

- partnerships which have a corporate member
- limited liability partnerships
- Lloyd's underwriters
- those using the special profit averaging rules for farmers, and creators of literary or artistic works
- farming businesses with a current herd basis election
- businesses that have claimed business premises renovation allowance
- ministers of religion
- businesses that have claimed research and development allowances.

Apart from these groups, all other unincorporated businesses should use cash basis from the 2024/25 tax year, unless they opt out.

Opting out requires a formal election, which is made on the tax return. The election has effect from the tax year in which it's made, and doesn't need to be made again. You can, however, revoke the election, and move back onto the cash basis, if you choose.

What difference does it make?

The basis on which accounts are taxed matters for two key reasons.

1. It impacts the information available to help you control and run the business.
2. It can impact cash flow and the timing of your tax liabilities.

We look at these in more detail below.

Changes to cash basis rules

Turnover limits: Turnover restrictions, previously governing entry and exit from the scheme, are removed from 6 April 2024. Businesses of any size can now use cash basis.

Interest costs: Previously, no more than £500 in interest costs could be deducted from taxable profits each year. This restriction is removed. Businesses can now deduct any amount of interest incurred wholly and exclusively for the purposes of trade. This gives parity with the accruals basis.

Loss relief: Previous restrictions to loss relief are removed. Cash basis losses can now be used in the same way as accruals basis losses: they can be set sideways against general income of the same period; or carried back to earlier years, subject to the same general loss relief rules as accruals losses.