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Cash basis for the smaller self-employed business

Cash is king?

This Briefing examines the new rules which have been introduced for 2013/14 onwards and which allow small unincorporated businesses to calculate their profits for tax purposes on a cash basis rather than the normal accruals basis. The accruals basis for example requires that credit sales are included in the accounts despite the fact that the customer has not yet paid for the goods or services.

Under cash basis the business is taxed on its cash receipts less allowable cash payments made in the accounting period. As this is an optional scheme we will talk to you over the next year as to whether it is suitable in your business circumstances but in the meantime thought it would be useful to outline how it operates.

The Briefing also considers the new fixed rate expenses rules that have been introduced for 2013/14 onwards.

Cash basis - Am I eligible?

The main entry criteria are that your business is unincorporated (sole trader or a partnership consisting only of individuals) and that your receipts in the accounting period are less than the VAT registration threshold in force at the end of the relevant tax year. The threshold for 2013/14 is therefore not yet known but is currently set at £79,000. For those individuals who intend to make a Universal Credit claim the threshold is set at twice the VAT registration threshold.

There are some individual exclusions from cash basis, for example, Limited Liability Partnerships, Lloyd's underwriters and those eligible

individuals who wish to continue to claim averaging of profits like farmers.

Once the cash basis election is made an individual will generally have to remain in the scheme unless the business either grows too large or there is another acceptable 'change of circumstances.' These matters are not considered further here.

Key tax points

- Cash receipts literally mean all cash receipts that the business receives during the accounting period. As well as trading income this will also include the proceeds from the sale of any plant and machinery. If a customer does not pay what is owed by the accounting year end then it will not be taxable until the next year when it is actually received by the business.

- In terms of what deductions can be claimed the main rules are that the expenses must have been actually paid in the accounting period as well as incurred wholly and exclusively for the purposes of the trade or business.
- As is the case with calculating taxable profits generally for a business no deductions are allowed for items which are of a capital nature such as the purchase of property. However, under the cash basis the costs of most plant and machinery can be included as a deduction. One key exception is the purchase of cars.
- If you have a business loan or overdraft only interest payments up to a maximum limit of £500 can be claimed. If, in the future, you have a larger loan and wish to claim more interest as a deduction then this could be treated as a change of circumstances and result in you then having your accounts prepared on the accruals basis.



- If your business incurs a loss then under the cash basis this can only be carried forward and set against profits of the same business in future years. This is not as advantageous as the normal rules which will allow the loss to be carried back or set off 'sideways' against other income.
- In order to ensure that income is taxed and expenses are relieved 'once and once only' special calculations are needed on entering or leaving the cash basis.

So, in summary, as you can see there is more to the cash basis than might be expected and we will undertake a review with you over the coming year to determine whether this will be appropriate for you and your business.

Fixed rate expenses

These rules have also been introduced and take effect for 2013/14 onwards. The basic idea is to allow the use of a 'simplified' fixed rate deduction instead of actual costs paid or incurred. It is optional, but using fixed rates may reduce the need for some of the detailed record keeping and calculations necessary to support tax deductible expenses. The amount of the overall tax allowable deductions could be greater or smaller compared to an actual cost comparison depending on the business circumstances.

Am I eligible?

The use of fixed rates is available to anyone who is self-employed whether the cash basis election is made or not. Partnerships can also use them as long as all the members of the partnership are individuals.

What do the fixed rates apply to?

Principally they apply to the following:

- business mileage
- deductions for business use of home
- adjustments for private use of business premises

Business mileage

Rather than claiming the actual deductions for purchasing, maintaining and running a motor vehicle or motorcycle businesses can calculate allowable expenditure using a fixed rate based on mileage. The rates are:

Cars and vans	
Up to 10,000 miles	45p per mile
Over 10,000 miles	25p per mile
Motorcycles	24p per mile

It is important to note that once the fixed rate is used for a particular vehicle, the same method must continue to be used for as long as the vehicle remains in the business. It will therefore be important to keep a detailed mileage log/diary. Additional business costs that are journey specific, such as parking fees and congestion charges will still need to be recorded and claimed. If capital allowances have been claimed the fixed rate cannot be used. Additionally, where for example a van has been claimed as an allowable payment under the cash basis, then the fixed rate cannot be used.

Business use of home

It is very common for self-employed individuals to work at least some of the time from home. Some tax relief is available if part of a home is used solely for the purpose of the business for a specified time. It is important however to ensure that part of the home is not exclusively used for business purposes unless absolutely necessary as this restricts the capital gains tax main residence exemption on the eventual sale of the home. Instead of recording actual costs on running a home (e.g. utilities,

telephone and internet charges) and claiming a business proportion, a fixed rate deduction can be claimed. If you decide to choose the fixed rate then the following apply:

Number of hours worked per month	Allowable amount per month
25 or more	£10
51 or more	£18
101 or more	£26

Hours worked is the number of hours spent wholly and exclusively on work done by yourself or an employee in your home wholly and exclusively for the purposes of the business. You can revert to actual costs in another year after choosing to use the fixed rate for one year.

Private use of business premises

If you use premises both as a home and as business premises for example a pub, the total expenses of the property need to be adjusted for private use. A fixed scale can be used to adjust for the private use which will increase taxable profits. Only premises which are used mainly for the purposes of carrying on a trade will qualify.

The fixed scale is as below and is for each month (or part month) falling within the period:

Number of relevant occupants	Flat rate per month
1	£350
2	£500
3 or more	£650

The 'number of relevant occupants' is based on how many people (including children) use the businesses premises each month (or part of a month) as a private home.

The law does not identify which expenses are included for this adjustment. HMRC have since issued a statement which indicates that the flat rate includes all household goods and services, food and non-alcoholic drinks and utilities but not mortgage interest, rent, council tax or rates. This appears to make the rates above expensive addbacks as a further adjustment is therefore required for these other expenses.

As with the cash basis election we will review with you whether a consideration of the fixed rate expenses is beneficial in your business circumstances. If you have any general questions in relation to the matters in this Briefing before we review your specific position do contact us.

