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VAT Cash Accounting Scheme

What is cash accounting?

Cash accounting enables you to account for VAT on the basis of payments received and made instead of on tax invoices issued and received.

The VAT payable or repayable for each accounting period will be the difference between the total amount of VAT included in payments received from your customers and the total amount of VAT included in payments made to your suppliers.

Who can use the scheme?

Cash accounting is open to you if you are a registered trader with an expected turnover not exceeding £1,350,000 in the next twelve months. The main conditions are that you should have made all necessary VAT returns and have made arrangements with HM Revenue & Customs to clear any arrears of VAT payments.

There is no need to apply to use the scheme, but you should start to use it at the beginning of a tax period.

Will it be beneficial to me?

It all depends on the period of time between your issuing sales invoices and receiving payment from your customers. The longer the time lag, the more of benefit cash accounting is likely to be. If you are usually paid as soon as you make a sale (e.g. if you use a retail scheme) you will normally be worse off under cash accounting. The same applies to the situation where you regularly receive repayments of VAT (e.g. because you make zero-rated supplies).

The potential disadvantage arises because you will no longer be able to take credit for VAT when you receive a tax invoice; you will have to wait until you have actually made the appropriate payment.

One major advantage of the scheme is that it simplifies your bookkeeping requirements, and many businesses can be controlled simply by using an appropriately analysed cash book. Another important advantage is that the problem of VAT on bad debts disappears - under conventional VAT accounting you have to pay VAT whether you have been paid by your customer or not, and VAT bad debt relief is not available until the debt is at least six months old.

What conditions are there once I start using the scheme?

You must use it for the *whole* of your business and must normally stay in it for at least two years (unless you exceed the turnover limit). However, you are allowed to leave the scheme at any time if you are not gaining any benefit or if your accounting system cannot cope with the requirements.

You must be careful that you do not account again for any VAT on receipts and payments already dealt with on invoices issued and received before you started using the scheme.

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Businesses are no longer able to use the scheme for sales of good and services invoiced in advance of the supply being made, or for sales where the payment is not due for more than six months after the invoice date.

What records must I keep?

The main accounting record will be a cash book summarising all payments made and received, with a separate column for the relevant VAT. You will also need to keep the corresponding tax invoices and ensure that there is a satisfactory system of cross-referencing.

These VAT records must be kept for six years, unless you have agreed a shorter period with your local VAT office.

Are there any special rules for cheques and credit cards?

A cheque receipt occurs on the date you receive the cheque or the date on the cheque, whichever is the later. If the cheque is subsequently dishonoured, you should adjust the VAT account accordingly.

Likewise, a cheque payment takes place on the date you send the cheque to your supplier or the date on the cheque, whichever is the later. However, if your cheque is dishonoured you cannot reclaim the VAT.

Credit card payments are to be accounted for by the date on the sales voucher - *not* the date you receive payment from, or make payment to, the card company.

What about part payments?

You must account for VAT each time you make or receive a payment, even if it is a part payment, and even if it is a payment in kind. Normally the VAT will be calculated using the VAT fraction (currently 1/6). However, a fair and reasonable apportionment must be applied if there is a mixed standard and zero-rated supply.

What if my turnover exceeds £1,350,000?

There is a 25% tolerance built into the scheme. This means that once you are using cash accounting, you can normally continue to use it until the annual value of your taxable supplies reaches £1,687,500.

You must review your taxable turnover in the year ending at the end of each tax period. If you exceed the tolerance of £1,687,500, you must leave the scheme immediately, unless HM Revenue & Customs allows or directs otherwise.

All outstanding tax must be accounted for within six months of the period in which you leave the scheme.

Do contact us if you would like more help or advice in this area.