Starfish Accounting

My Virtual Financial Controller

Financial Wizardry for the Self Employed

Cash basis accounting vs. traditional accounting

"On a mission to help women in business"

Accounting, tax & bookkeeping services
for women in business & microbusiness

Jargon busters

Cash basis accounting vs. traditional accounting

A new way of working out your income and expenses was introduced for the 2013-2014 tax year – "cash basis" accounting. What is it, and would it work for you?

Eligibility

If you are self-employed, and your income is £81,000 or less, then you can start using the cash basis from the 2013-2014 tax year.

You can stay in the cash basis until your business income goes over £162,000 per year, and then you have to use traditional accounting.

How does it work?

This is quite a straight forward approach. You include your income and expenses based on when the money comes in and goes out.

This is different from the traditional way of recording your transactions which is instead based on when you do the work or when you receive the product or service, NOT on when the cash movements happen.

Cash basis accounting also avoids having to worry about capital allowances, you simply put through any equipment you buy as a normal allowable business expense (note this is not the case for cars).

How do you tell the tax man that is what you are doing?

Simply tick the cash basis box on the form when you submit your 2013-2014 tax return.

What's the catch?

On the face of it cash basis accounting is more straight forward and will save you time and effort in keeping track of your numbers and doing your tax return. BUT – there are a couple of big catches that you need to be aware of:

- If your self-employed business is loss making, and you have other income, you probably **don't** want to follow cash basis accounting. It stops you from being able to offset those losses against other income in the same tax year, so could cost you £000s in potential tax refunds in the short term;

- If your business is more complicated (e.g. if you are VAT registered) then you will need to have better records than cash basis accounting will give you;
- If your self-employed business incurs more than £500 interest per year as it limits what you can put through as an expense.

What is the right answer for me?

If you have a very straight forward self-employed business that is making low to medium profits, and you don't have high interest costs, then this could be for you. It is quicker and easier to do your accounts and tax return.

However, if this doesn't describe your business you are likely better to follow traditional accounting methods.

The majority of the guidance in My Virtual Financial Controller applies to both cash basis and traditional accounting. Where it only applies to one or the other that will be made clear in the introduction.