How to keep the cash flowing

Indirect Tax



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Kevin Hall and *Punnit Vyas* consider cash flow improvement during Covid-19, including bad debt relief and cash accounting

Key Points

What is the issue?

Businesses will need to do all they can in the economic downturn caused by Covid-19 not just to keep afloat, but to keep cash flowing through the business.

What does it mean for me?

VAT, which normally amounts to a large and significant monetary figure within the business, can be reviewed in a number of ways to identify opportunities for VAT efficiencies and cash flow improvements.

What can I take away?

As well as the government announcement of VAT deferral, bad debt relief and cash accounting are other opportunities for relief within the VAT system.

In these uncertain times, businesses will need to do all they can in the economic downturn caused by Covid-19 (however long that may last) not just to keep afloat, but to keep cash flowing through the business. After all, cash is king, and if the business can improve cash flow that might just make all the difference. This article explores how VAT, which normally amounts to a large and significant monetary figure within the business, could be reviewed in a number of ways to identify opportunities for VAT efficiencies and cash flow improvements.

Immediate relief: VAT deferral

So far in terms of Covid-19 support through the VAT system, the headline announcement that came in good time by the government has been the VAT deferral. That measure allows for VAT payments falling due between 20 March 2020 and 30 June 2020 to be deferred until 31 March 2021, with no interest or default surcharge payable. Businesses paying VAT by direct debit have been advised to cancel the debit at least seven days in advance, if they want to take advantage of the deferral, and then reinstate it for the next quarter. However, a number of other reliefs and opportunities that already exist within the VAT system could also help too, and a few of these are highlighted below.

Bad debt relief

Over the coming months, there is a distinct possibility that businesses will be unable to pay their suppliers, meaning that businesses having invoiced for goods and

services supplied will not get paid. On an accruals basis, the business will have raised its invoice and accounted for it as output tax in the VAT return period in which the date of the invoice falls. A business making taxable supplies at the standard rate will have, at the point the VAT return was submitted, accounted for the amount as output tax to HMRC, but will not have received payment from their customer (and may never receive it).

Bad debt relief is the mechanism through which the taxpayer claws back from HMRC the VAT paid to it where the taxpayer has not been paid by the customer for six months, the debt has been written off and the amount placed in a bad debt relief account.

Taking a straightforward example, an accountancy firm issued an invoice for £1,000 plus VAT of £200 to a client with a due date of 1 August 2019. No payment whatsoever has been received and all of the conditions for claiming bad debt relief have been met (see Box 1 for conditions). VAT bad debt relief of £200 could be claimed on the VAT return for the quarter covering February 2020 in relation to this invoice.

Process for claiming

The process for claiming VAT bad debt relief is automatic; i.e. it does not require a separate election or claim to HMRC. The method of claiming is to include the amount of the VAT in Box 4 of the VAT return for the period in which the conditions for making the claim are first met or in a later VAT return.

There may be more complex situations where, for example:

- there have been part payments;
- more than one VAT rate is involved;
- VAT only invoices are involved; or
- the debt subsequently is paid.

An interesting point arises regarding partially exempt businesses claiming bad debt relief, particularly those on the standard method or those on a turnover based method. Within partial exemption calculations, on an accruals basis the turnover would include the sale; however, although the bad debt relief ‘reverses’ the output VAT on the sale, it does not reverse the sale itself and would not directly impact on the recovery rate under the partial exemption method.

Interestingly, if the business was using cash accounting (see below), then turnover for partial exemption would be on the basis of the actual monies received and unpaid debts will affect the recovery rate.

Interaction with the VAT deferral

Another point arises from the recently announced VAT deferral, this time in its interaction with bad debt relief. The deferral was announced in the context of the government's rapid response to Covid-19 and support for businesses, and so it is not surprising that much of the detail was left to be determined by HMRC sometime after.

Currently, the first condition for claiming bad debt relief includes the words 'and paid to HMRC'. Therefore, any debts that go bad which originated in a VAT period that had its payment deferred between 20 March 2020 and 30 June 2020 (as per the deferral period) will not meet the payment condition and normally cannot therefore be claimed until such time as the VAT has been paid, which, according to the deferral scheme, will be 31 March 2021. We are aware of clients who have been informed by HMRC that bad debt relief will be honoured where the liability was included in VAT returns during the deferral period and are still unpaid after six months, which would be in the spirit of the government's aim of supporting businesses' cash flow during the Covid-19 economic pause. Watch for further announcements.

In the meantime, the optimal position for most businesses will be to ensure that they review bad debts over the last four years in order to ensure that no VAT bad debt relief is lost due to the four year cap. Timing of any VAT bad debt relief claim could be significant where net VAT return payments are deferred under Covid-19.

Cash accounting

Cash accounting provides automatic VAT bad debt relief, as output tax does not have to be accounted for until payment is received from the customer. It is therefore more efficient than being on an accruals basis and making VAT bad debt relief claims. In these challenging times, businesses might find they have a higher number of defaulters and, provided they meet the eligibility conditions for the cash accounting scheme (see Box 2), then this is definitely something to consider.

There is a note of caution in terms of the cash flow benefit, however. Although the scheme provides a neat solution to regular VAT bad debt relief claims, it does not benefit those who are regularly in a repayment position. Most businesses will find an overall cash flow benefit on cash accounting.

Process for claiming

Like bad debt relief, there is no formal process for applying to HMRC before beginning to use the scheme. If the conditions are met, you can use it and calculate your VAT return accordingly from the start of your next VAT return period (you cannot apply the scheme retrospectively to your business).

Other cash flow improvements

Certainly, along with the VAT deferral scheme, bad debt relief and cash accounting, there are other areas to consider. We briefly highlight a few of these below:

- Accelerated or deferred tax points: can invoices be issued later or earlier (to the extent permissible within the normal invoicing tax point rules) in order that cash flow for the business is improved?
- Can ‘Time to Pay’ be agreed with HMRC for any existing or new VAT or tax debts to HMRC?
- If you do not normally pay HMRC by direct debit, then consider this method of payment as businesses which pay by direct debit normally have a further three bank working days in which to pay.
- If you make payments on account to HMRC through the Payments on Account scheme or from the Annual Accounting Scheme, consider contacting HMRC to cancel or reduce these payments on account, as they may now be too high and could therefore create cash flow problems in the months ahead.

This is not intended to be an exhaustive list, but it could provide some much needed help to businesses’ cash flow to assist them through the downturn and promote recovery to the health of their business.

BOX 1: Conditions for claiming bad debt relief

1. You must already have accounted for the VAT on the supplies and paid it to HMRC.
2. You must have written off the debt in your day to day VAT accounts and transferred it to a separate bad debt account.
3. The value of the supply must not be more than the customary selling price.
4. The debt must not have been paid, sold or factored under a valid legal assignment.
5. The debt must have remained unpaid for a period of six months after the later of the time payment was due and payable and the date of the supply.

HMRC VAT public notice 700/18

Box 2: Cash accounting eligibility conditions

- You are eligible to start using the scheme if you meet the following conditions:
- you expect the value of your taxable supplies in the next year will be £1,350,000 or less;
- you have no VAT returns outstanding;
- you have not been convicted of a VAT offence in the last year;
- you have not accepted an offer to compound proceedings in connection with a VAT offence in the last year;
- you have not been assessed to a penalty for VAT evasion involving dishonest conduct in the last year;
- you do not owe HMRC any money or, if you do, you have made arrangements with it to clear the total amount of your outstanding VAT payments (including surcharges and penalties);
- HMRC has not written to you withdrawing use of the scheme during the last year;
- HMRC has not written to you and denied you access to the scheme; and you comply with the conditions set out in public notice 731.

HMRC VAT public notice 731

- We should very much appreciate your completing our survey about the impact of coronavirus on you and your organisation. We are gathering this information to help us continue to support and inform you. Please click here to complete the survey. The closing date is 30 June and we shall provide a report on our websites in July.