



Late-payment rules and cashflow protection for SMEs

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SPOTLIGHT ON:

Late-payment rules and
cashflow protection for SMEs



TIPS TO HELP YOUR BUSINESS GET PAID ON TIME

Late payment can turn a profitable sale into a cashflow problem. A business may have completed the work, paid its employees and suppliers, and accounted for tax before the customer settles the invoice.

The scale of the problem remains significant. Research commissioned by the Department for Business and Trade and the Office of the Small Business Commissioner estimates that late payments cost the UK economy almost £11 billion a year. Around £26 billion is owed to businesses in late payments at any one time, affecting more than 1.5 million businesses, or 28% of the business population. Among businesses affected, the average amount outstanding is approximately £17,000.

The same research estimated that 14,000 businesses close each year because of late payments, while affected businesses spend an average of 86 staff hours a year chasing overdue invoices.

Payment performance has improved in some parts of the economy. The latest Department for Business and Trade statistics, published in July 2026, show that large businesses paid suppliers in an average of 32 days during 2025. They paid 15% of invoices late, compared with 25% when reporting began in 2018.

For SMEs, good cashflow management therefore starts before an invoice becomes overdue.

WHEN DOES A BUSINESS PAYMENT BECOME LATE?

The rules on late commercial payments apply to qualifying transactions between businesses for goods and services.

Where businesses agree a payment date, payment terms for private-sector business transactions should usually be no longer than 60 days. Businesses can currently agree a longer period, but it must be fair to both parties.

Public authorities are generally expected to pay within 30 days.

Where no payment date has been agreed, a commercial payment normally becomes late 30 days after the later of the customer receiving the invoice or the goods or services being supplied.

These rules make written payment terms particularly important. An invoice that simply says "payment due" without matching clear contractual terms can create unnecessary uncertainty when payment is chased.

Terms should establish when an invoice falls due, which payment methods are accepted, what information the customer needs to approve it and what happens if payment is late.

For larger or longer projects, businesses may also want to consider deposits, staged invoicing or payments linked to agreed milestones rather than waiting until all work has been completed before raising a single invoice.

STATUTORY INTEREST ON LATE COMMERCIAL DEBTS

Under the Late Payment of Commercial Debts (Interest) Act 1998, businesses can have a statutory right to charge interest when another business pays late.

The statutory rate is 8% above the applicable Bank of England base rate.

For this purpose, the reference rate is fixed for six-month periods. The Bank of England rate in force on 30 June applies from 1 July to 31 December, while the rate on 31 December applies from 1 January to 30 June.

The Bank Rate was 3.75% on 30 June 2026, so the statutory late-payment interest rate for qualifying debts becoming late between 1 July and 31 December 2026 is 11.75% a year.

For example, suppose a business has a qualifying £5,000 invoice that becomes overdue during this period and remains unpaid for 45 days.

At 11.75%, the statutory interest for those 45 days would be approximately £72.43.

Interest normally runs from the date the payment becomes late until payment is made.

Businesses should check their contracts before applying statutory interest. If a contract already provides its own late-payment remedy or rate of interest, the statutory regime may not apply.

COMPENSATION FOR RECOVERING LATE PAYMENTS

Interest is not the only amount that may be recoverable. Businesses can also claim a fixed amount towards the cost of recovering a qualifying late commercial payment. The statutory compensation currently depends on the size of the debt:

Amount owed	Fixed compensation
Up to £999.99	£40
£1,000 to £9,999.99	£70
£10,000 or more	£100

The charge applies to each qualifying late payment. Reasonable additional recovery costs may also be recoverable in appropriate circumstances.

Using the previous £5,000 example, the business could potentially claim £72.43 of interest after 45 days plus the £70 fixed recovery amount – a total of £142.43, before considering any further qualifying recovery costs.

Charging interest and compensation is a commercial decision as well as a legal one. Some businesses include the possibility of statutory charges in their standard payment reminders before formally applying them.

PREVENTING LATE PAYMENT BEFORE IT STARTS

A large part of effective credit control happens before the due date. Businesses should build payment management into their sales process rather than treating debt collection as a separate task once something has gone wrong.

A practical system should cover the following:

- Check new customers before extending credit. Review Companies House information where relevant, carry out proportionate credit checks and establish a sensible credit limit. For significant contracts, consider whether the level of exposure would create a problem if payment arrived one or two months late. It can also be a good idea to ask a customer for their full set of statutory accounts (rather than just the ones available on Companies House).
- Agree payment terms before starting work. State the payment deadline clearly in contracts, quotations or engagement documents. Make sure the customer has accepted the terms rather than introducing them for the first time on the invoice.
- Understand the customer's payment process. Larger organisations may require purchase-order numbers, supplier registration, specific invoice portals or departmental approval. Find out what is required before the first invoice is raised.
- Invoice promptly and accurately. Delaying an invoice by ten days effectively gives the customer ten extra days of credit. Incorrect addresses, missing purchase-order numbers and unclear descriptions can also give customers legitimate reasons to delay approval.
- Make payment straightforward. Provide clear bank details and appropriate payment options. For regular customers, automated payment methods such as Direct Debit can reduce administration and missed due dates.
- Send reminders before and after the due date. Accounting software can automate reminders, but communication should become more personal as an invoice becomes increasingly overdue. A telephone call can often identify an approval problem or genuine dispute faster than repeated automated emails.
- Escalate consistently. Set internal points at which an overdue account moves from a reminder to a call, formal demand, suspension of further credit or external recovery action. Avoid allowing a large balance to accumulate simply because the customer has historically paid eventually.
- Monitor customer concentration. A business may have healthy overall sales while becoming too dependent on one or two slow-paying customers. Review how much of the trade debtor balance relates to individual customers and sectors.

USE PAYMENT DATA BEFORE ACCEPTING LARGE CUSTOMERS

Businesses selling to larger companies can access useful information before agreeing substantial credit terms.

Large companies and LLPs that fall within the reporting requirements must publish information on their payment practices at least twice a year. Current size tests include businesses meeting at least two of the following thresholds: £54 million turnover, £27 million balance-sheet total and 250 employees.

Published information can show how long a business typically takes to pay suppliers, the proportion of payments made within 30 days, between 31 and 60 days and after 60 days, and the proportion of payments that were late against agreed terms.

This can provide useful evidence when deciding whether to accept a customer's requested payment terms or how much credit to offer.

WHAT THE FAIR PAYMENT CODE TELLS SUPPLIERS

The previous Prompt Payment Code has been replaced by the Fair Payment Code, administered by the Office of the Small Business Commissioner.

It operates through three award levels.

A Gold Award requires businesses to pay at least 95% of all invoices within 30 days. Silver requires at least 95% of all invoices to be paid within 60 days, including at least 95% of invoices to small businesses with fewer than 50 employees within 30 days. Bronze requires at least 95% of all invoices to be paid within 60 days.

Businesses dealing with a Fair Payment Code award holder can therefore use its award status as one indicator of payment performance, although normal credit checks should still form part of the decision.

WHAT TO DO WHEN AN INVOICE BECOMES OVERDUE

The first step should usually be to establish why the payment has not been made.

Confirm that the customer received the invoice and has all the supporting information required. Ask whether the invoice has been approved, whether there is a genuine dispute and when payment will be released.

Where the customer acknowledges the debt but has temporary financial difficulties, a written payment plan may sometimes provide a better outcome than immediate legal proceedings. Any arrangement should set out instalment dates and amounts clearly.

If normal reminders fail, a business can send a formal demand setting out the amount outstanding, the original payment date, any interest or recovery costs being claimed and the deadline for settlement.

Before commencing court proceedings, businesses should consider the likely recovery costs, the value of the debt and the financial position of the customer. Winning a claim does not guarantee recovery if the customer has no funds or is insolvent.

SUPPORT FROM THE SMALL BUSINESS COMMISSIONER

The Office of the Small Business Commissioner provides free support to small UK businesses facing payment problems with larger private-sector customers.

For its existing complaint service, it defines a small business as one with fewer than 50 employees. The office can provide guidance and, in qualifying cases, contact a larger customer and investigate an unresolved payment dispute.

Businesses considering this route should normally contact the Commissioner before starting court proceedings, as the office may no longer be able to assist once legal action has begun.





PROTECTING CASHFLOW FROM UNPAID INVOICES

Credit control should sit alongside broader cashflow planning.

An aged-debtor report should be reviewed regularly rather than only at the financial year end. Tracking amounts that are current, 30 days overdue, 60 days overdue and older can highlight deteriorating payment behaviour early.

Cashflow forecasts should also use realistic collection dates. If a significant customer routinely pays 15 days after its contractual deadline, assuming that every invoice will arrive on the due date can overstate the cash available to the business.

Businesses should also distinguish between turnover and cash. Increasing sales on lengthy credit terms can increase reported revenue while placing additional pressure on working capital.

CONSIDER THE VAT EFFECT OF LATE PAYMENT

VAT can add another cashflow pressure. Under standard VAT accounting, a business normally accounts for VAT based on its sales and purchase invoices even when the customer has not yet paid. This can mean paying VAT to HMRC before collecting the corresponding cash from the customer.

Eligible VAT-registered businesses can consider the VAT Cash Accounting Scheme, under which VAT on sales is generally paid when customers pay the business.

For 2026/27, businesses can generally join where estimated VAT-taxable turnover for the next 12 months is £1.35 million or less. A business normally has to leave if its VAT-taxable turnover rises above £1.6 million.

The scheme will not suit every business because input VAT is also normally reclaimed when suppliers are paid rather than when their invoices arrive.

Where VAT has already been accounted for under normal VAT accounting and a debt later proves irrecoverable, VAT bad debt relief may be available. Among the conditions, the debt must normally have remained unpaid for at least six months after the later of the payment due date and the date of supply, and the debt must have been written off in the business's VAT records.

Claims generally need to be made within four years and six months of the later of those dates.

LATE-PAYMENT LAW IS SET TO CHANGE

Businesses should also be aware that the Government is progressing significant changes to commercial payment law.

The Commercial Payments Bill was introduced in May 2026. As at 7 August 2026, it has completed committee stage in the House of Lords but has not yet become law. Its report stage is still to be scheduled.

The Government's proposals include a firm maximum payment period of 60 days for many business-to-business contracts, subject to limited exemptions. Current proposals indicate that the new maximum would begin no earlier than 2027. The Government has identified possible exemptions where both parties are large businesses, where the purchaser is the smaller party and for certain imports and exports.

The Bill would also make statutory late-payment interest mandatory rather than leaving suppliers to decide whether to claim it, strengthen the Small Business Commissioner's enforcement and dispute-resolution powers and introduce additional scrutiny of poor payment behaviour by large businesses.

These proposed measures should not yet be treated as part of the current late-payment regime. Businesses should review their contracts and credit-control procedures again once the legislation receives Royal Assent and commencement dates have been confirmed.

MAKE PAYMENT MANAGEMENT PART OF FINANCIAL MANAGEMENT

Late payment cannot always be prevented, but businesses can reduce their exposure.

Clear contracts, prompt invoicing, sensible credit limits, regular debtor reviews and consistent follow-up all improve the chances of getting cash into the business when expected.

Where payment is delayed, businesses should understand the legal rights available to them, including statutory interest and recovery compensation. They should also consider the tax and cashflow effects of carrying unpaid invoices for long periods.

Most importantly, debtor management should not begin when an invoice is already 60 or 90 days overdue. Treating payment terms, invoicing and credit control as part of the normal financial management cycle gives businesses much more opportunity to identify problems before an unpaid invoice starts affecting payroll, tax payments, supplier commitments or investment plans.



If you need help improving your cashflow, managing late payments or strengthening your credit-control processes, contact us to discuss how we can help.



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