Introduction to the VAT Flat Rate Scheme

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The purpose of this official VAT scheme is to simplify your VAT accounting and so reduce the cost of complying with your VAT obligations. In theory some businesses win and some lose when adopting this scheme. In practice you will only join it if you expect to benefit from so doing.

Before applying to use the scheme you should compare the amount of VAT you would be required to pay to HMRC as compared with how much would otherwise be payable.

How does the scheme work?

Normally the VAT you pay to HMRC is the difference between the VAT you charge your customers and the VAT you pay on your purchases. Using the Flat Rate Scheme you simply pay VAT as a fixed percentage of your VAT inclusive turnover. The actual percentage you use depends on your type of business. The amount of VAT you pay on your business expenses becomes irrelevant to your VAT returns.

Turnover limits

You can only apply to use the Flat Rate Scheme if you expect your annual taxable turnover in the next 12 months to be no more than £150,000, excluding VAT. Your annual taxable turnover is the total of everything that your business sells during the year. It includes standard, reduced rate or zero rate sales and other supplies. It excludes the actual VAT charged, VAT exempt sales and sales of any capital assets. Special rules apply if you sell capital assets worth more than £2,000.

The turnover test applies to your expectations as regards business turnover in the coming 12 months. You should retain evidence of your calculations. Your forecast may be calculated in any reasonable way but would usually be based on the previous 12 months if you have been in business for at least a year.

Once you join the scheme you can stay in until your total business income is more than

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£230,000 including VAT in a 12 month period.

Who can't join the scheme?

You cannot join the Flat Rate Scheme if:

- you have previously been registered and only came out of the scheme in the last 12 months;
- you are, or were, within the previous 24 months, registered for VAT as the division of a larger business, or as part of a group, or you were eligible to do so;
- you use one of the margin schemes for second-hand goods, art, antiques and collectibles, the Tour Operators' Margin Scheme, or the Capital Goods Scheme;
- you have been convicted of a VAT offence or charged a penalty for VAT evasion in the last year; or
- your business is closely 'associated' with another business

Notifying HMRC

To join the scheme you must apply to HMRC. This can be done by post, email or phone. If your business needs to register for VAT you can apply for the Flat Rate Scheme at the same time. The necessary forms can be downloaded from HMRC's website.

Advantages & Disadvantages of the scheme

Advantages

- Saves time and smoothes your cashflow;
- Removes the need to track all of the VAT you pay on your business purchases;
- A first year discount for businesses in their first year of VAT registration of 1%;
- Significantly fewer rules to follow and peace of mind as there's less to get wrong; and
- More certainty as to what percentage of takings will be due to HMRC.

Disadvantages

The scheme is unlikely to be beneficial for your business if you:

- Spend more on standard-rated business expenses than HMRC consider typical for your business sector;
- Regularly receive a VAT repayment under standard VAT accounting; or
- Make a lot of zero-rated or exempt sales.

Other official VAT schemes

Annual Accounting Scheme

You can use the Flat Rate Scheme in conjunction with the Annual Accounting Scheme. Businesses that use the Annual Accounting Scheme make nine monthly or three quarterly interim payments throughout the year together with one VAT Return at the end of the

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year together with a balancing payment or refund.

Cash Accounting Scheme

You can't use the Flat Rate Scheme with the Cash Accounting Scheme. However, the Flat Rate Scheme has its own cash based method for calculating turnover.

Retail schemes

You can't use the Flat Rate Scheme with any of the retail schemes. However, the Flat Rate Scheme does have flat rates suitable for use by certain retailers.

Invoicing customers and clients

Your invoices will not change when you move onto the Flat Rate Scheme. You will continue to be required to issue valid VAT invoices in the usual way to all customers and clients.

Record keeping

Once you are using the Flat Rate Scheme you must keep a record of your flat rate calculations showing:

— the flat rate turnover figures you used – in case your turnover exceeds the limit in the coming 12 months;
— the flat rate percentage you have used; and
— the VAT you have calculated is due each period.

Businesses must still keep a VAT account although if the only VAT to be accounted for is that calculated under the scheme there will only be one entry for each period.

Leaving the scheme

You can leave the scheme at any time by notifying HMRC usually at the end of your next VAT accounting period.

Businesses must also leave the scheme:

— On the anniversary of joining the scheme if your previous year's VAT-inclusive turnover was more than £230,000;
— If you expect your VAT inclusive turnover in the next 30 days alone will be more than £230,000;
— You start to use one of the other special schemes such as one of the margin schemes for second-hand goods, art, antiques and collectibles, the Tour Operators' Margin Scheme, or the Capital Goods Scheme
— Your business becomes part of a larger group or division or becomes eligible to do so.

Businesses that leave the Flat Rate Scheme are unable to rejoin it for at least 12 months.

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Flat rate Scheme percentages

Flat Rate Scheme percentage rates are set out in official tables and range from 4% to 14.5%. There are over 50 trade sectors highlighted on the official tables.

The flat rate you should use will depend on which trade sector most accurately reflects your business. If your business includes supplies in two or more sectors, you should use the percentage that is appropriate to your main business activity as measured by expected turnover in the year ahead.

Changes in the standard VAT rate

When the VAT rate changes during a VAT accounting period, businesses will have to do the following calculations for that period:

- Apply the old percentage rate to their flat rate turnover from the start of the period up to the day before the rate changes.
- Apply the new percentage rate to their flat rate turnover from the first day of the new rate to the end of the period.
- Add the two figures together to produce the total VAT owed to HMRC for the period.

First year discount

Businesses benefit from a 1% reduction in the flat rate percentages for the first year of VAT registration. The discount continues to apply even if the flat rate percentage changes during the first year of registration.

Capital assets

If you use the Flat Rate Scheme, you can't normally claim back the VAT you spend on capital assets you buy for your business. However, if you are spending £2,000 or more on individual assets you may be able to claim back the VAT if certain tests are satisfied.

How we can help

We would welcome the opportunity to advise you on any of the issues related to registering for the Flat Rate Scheme. We can also help you choose the most appropriate and beneficial flat rate and help you with your VAT record keeping requirements. We can also help you retain all the related necessary information to support your approach and so avoid penalties and problems down the line.

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