CHADDESLEY SANFORD

FLAT RATE VAT SCHEME

What is the Flat Rate VAT Scheme?

The Flat Rate VAT Scheme is designed as a simplified way of recording, reporting and paying VAT liabilities for small VAT-registered entities. The VAT liability payable under a flat rate scheme is calculated differently to the liability calculated under a regular scheme and there are a number of factors to consider before making the decision to join this scheme.

Can I Use the Flat Rate Scheme?

Any VAT-registered business that expects its VAT taxable turnover to be less than £150,000 in the next 12 months can use the flat rate scheme. (See "What else do I need to consider?" (below) for thresholds at which you have to leave the scheme).

What is the Flat Rate VAT Scheme?

Standard Scheme

Under a normal VAT registration, your business collects VAT from your customers (normally at a rate of 20% of the net sale price of your goods / services) and pays VAT to your suppliers. The difference between the amount you've collected from your customers and the amount you've paid to your suppliers is then paid over to HMRC, usually on a quarterly basis. This seems to be a simple process but in reality, many of your purchases (e.g. travel on public transport, cold takeaway snacks, milk for the office, purchases from suppliers who aren't VAT registered to name but a few) won't include VAT or could include VAT at a different rate (electricity bills often include VAT at 5% for example). Under the regular scheme, you need to make sure that you accurately record and report the VAT treatment of every single purchase and then add them all up to declare to HMRC.

Flat Rate Scheme

Under the flat rate scheme, you can more or less ignore the VAT treatment of your purchases, other than capital items over a certain value (see "What are the potential benefits?" below). Instead, you take your gross sales value for the period and multiply it by a flat rate percentage based on your industry sector (see appendix one of this report) or a flat rate of 16.5% if your business is a limited cost trader (see "Am I a Limited Cost Trader?" below) and this will be the amount you pay over to HMRC. The difference between this and the amount you have collected from your customers is your compensation for VAT suffered on your purchases.

What are the Potential Benefits?

The more costs your business incurs that include VAT, the less likely it is that the flat rate scheme will be financially beneficial, although the industry specific percentages (see end of whitepaper) do attempt to address that issue.

Pubs for example have a flat rate of 6.5% on the understanding that they will need to purchase large volumes of alcoholic drinks for resale – all of which would normally be subject to 20% VAT.

However, let's say for example that you provide management consultancy services (flat rate 14% from table below). You work from home (so no rent), travel by public transport (which is exempt from VAT) and eat sandwiches at your desk (zero rated for VAT). It's possible then that the only VAT you're likely to incur is on some stationery costs and on your accountancy fees.

If we put that into a worked example assuming say £100k annual VAT-able turnover and £5k of annual VAT-able costs we come up with the following:

Regular VAT Scheme

£100k turnover VAT charged and collected at 20%	**£20,000**
Less £5k VAT-able costs VAT suffered at 20%	**(£1,000)**
VAT payable to HMRC (VAT charged less VAT incurred)	**£19,000**

Flat Rate VAT Scheme

£100k turnover VAT charged and collected at 20%	**£20,000**
Gross turnover (£100k + £20K)	**£120,000**
VAT payable to HMRC @ 14% of gross	**£16,800**

Clearly then in this example, as well as the practical benefits you would also be £2,200 better off financially.

The above examples demonstrate the benefits only where your business is not at risk of being a limited cost trader (please see 'Am I A Limited Cost Trader?' below).

However, using the same scenario as above, if we put that into a worked example for a limited cost trader assuming the same £100k annual VAT-able turnover but £2k of annual VAT-able costs we come up with the following:

Regular VAT Scheme

£100k turnover VAT charged and collected at 20%	**£20,000**
Less £2k VAT-able costs VAT suffered at 20%	**£400**
VAT payable to HMRC (VAT charged less VAT incurred)	**£19,600**

Flat Rate VAT Scheme

£100k turnover VAT charged and collected at 20%	**£20,000**
Gross turnover (£100k + £20k)	**£120,000**
VAT payable to HMRC @ 16.5% of gross	**£19,800**

In this example you would be £200 worse off financially however you would need to determine whether the practical benefit of not having to record VAT on your purchases would outweigh this additional cost.

Furthermore the following two points should be considered:

1. If this was the first year of VAT registration then you would also receive a 1% discount on your flat rate percentage making the savings even greater.
2. If you purchase a "capital good" for the business (e.g. a laptop computer) with a value (including VAT) of more than £2,000 then you can claim the VAT back on that purchase even if you are on the flat rate scheme at the time.

Flat Rate VAT Scheme

As you can see from the above, the less costs you have, the higher the benefit is of being on the VAT Flat Rate Scheme. From 01 April 2017, the government have introduced a 16.5% VAT flat rate for businesses who have limited costs.

To determine whether you should use this 16.5% rate, you need to consider the following test:

Is your VAT inclusive expenditure on **goods** (not services) less than 2% of your VAT inclusive turnover in a prescribed accounting period?

YES – Your business is a limited cost trader and you need to use the flat rate of 16.5%.

NO – Is your VAT inclusive expenditure on goods (not services) more than 2% of your VAT inclusive turnover and less than £250 per quarter in a prescribed accounting period?

- **YES** – Your business is a limited cost trader and you need to use the flat rate of 16.5%.
- **NO** – Your business is not a limited cost trader and you can use your industry specific % to calculate your VAT.

When considering the above, goods referred to must be wholly and exclusively for the purposes of the business but they do exclude the following:

- Capital Expenditure.
- Food or drink for consumption by the business/its employees.
- Vehicles, vehicle parts and fuel (unless the business carries out transport services e.g. a taxi).

You need to monitor the above on a regular basis. As part of our quarterly review service we will review this and flag any possibility of your company being considered a Limited Cost Trader but please do get in touch if you have any queries.

What Else do I Need to Consider?

You need to carefully consider your current and future situation before deciding whether to join the flat rate scheme and at what point you would want to do so (you don't have to join immediately upon registration for VAT).

However there are a number of other nuances of the scheme that you would need to be aware of both before making a decision to join and whilst using it. These include:

- Your business will receive a 1% discount on your flat rate but this only applies to the first year of VAT registration (not the first year after joining the flat rate scheme) so if for example you registered for VAT on 01/01/17 but then didn't join the flat rate scheme until 01/07/17, you would only receive the 1% discount for 6 months up until 31/12/17.
- You won't be entitled to the 1% discount if you register for VAT 12 months after you were required to do so.
- You can voluntarily leave the scheme at any point (by writing to HMRC) but you are then excluded from re-joining for the next 12 months.
- You must leave the scheme immediately if on any anniversary of joining, your turnover in the last 12 months was more than £230,000. Importantly it must be considered that the £230,000 leaving threshold (unlike the joining one) must be calculated including VAT and also including sales exempt from or outside the scope of VAT.
- It's often difficult to determine what industry sector your business falls under, and so what flat rate percentage it can use. It's important that you can show that you've given due consideration at the time of making this decision to avoid the risk of HMRC challenging the rate used and forcing you to backdate any change.

What do I do next?

If you're interested in discussing in further detail whether your business would be eligible for and / or benefit from the flat rate VAT scheme please give Matthew Gambold a call on **0207 183 6088** or email him on **matthew.gambold@chadsan.com.**

CHADDESLEY SANFORD

Appendix:
HMRC Flat Rate VAT Percentages by Industry Sector

Type of Business	Current VAT flat rate (%)
Accountancy or book-keeping	14.5
Advertising	11
Agricultural services	11
Any other activity not listed elsewhere	12
Architect, civil and structural engineer or surveyor	14.5
Boarding or care of animals	12
Business services not listed elsewhere	12
Catering services including restaurants and takeaways	12.5
Computer and IT consultancy or data processing	14.5
Computer repair services	10.5
Entertainment or journalism	12.5
Estate agency or property management services	12
Farming or agriculture not listed elsewhere	6.5
Film, radio, television or video production	13
Financial services	13.5
Forestry or fishing	10.5
General building or construction services*	9.5
Hairdressing or other beauty treatment services	13
Hiring or renting goods	9.5
Hotel or accommodation	10.5
Investigation or security	12
Labour-only building or construction services*	14.5
Laundry or dry-cleaning services	12
Lawyer or legal services	14.5
Library, archive, museum or other cultural activity	9.5
Management consultancy	14
Manufacturing fabricated metal products	10.5
Manufacturing food	9
Manufacturing not listed elsewhere	9.5
Manufacturing yarn, textiles or clothing	9
Membership organisation	8
Mining or quarrying	10
Packaging	9
Photography	11
Post offices	5
Printing	8.5
Publishing	11
Pubs	6.5
Real estate activity not listed elsewhere	14
Repairing personal or household goods	10
Repairing vehicles	8.5
Retailing food, confectionary, tobacco, newspapers or children's clothing	4
Retailing pharmaceuticals, medical goods, cosmetics or toiletries	8
Retailing not listed elsewhere	7.5
Retailing vehicles or fuel	6.5
Secretarial services	13
Social work	11
Sport or recreation	8.5
Transport or storage, including couriers, freight, removals and taxis	10
Travel agency	10.5
Veterinary medicine	11
Wholesaling agricultural products	8
Wholesaling food	7.5
Wholesaling not listed elsewhere	8.5