

VAT Scheme

This factsheet is designed to give a brief overview of Flat Rate VAT Scheme for small businesses.

If you are using the standard VAT accounting scheme you pay VAT to HMRC calculated as the difference between the VAT charged to your customers and the VAT paid on your purchases. Under the flat rate VAT scheme you simply apply a fixed percentage to your VAT inclusive turnover and pay this over in VAT to HMRC which reduces the administration burden of your VAT reporting.

Who can join the Scheme?

To join the Flat Rate VAT Scheme you must first be registered for VAT, you can then apply to join the scheme if you meet the following condition:

- Your expected turnover in the next year will be £150,000 or less. This is excluding VAT but does include the total of all sales during the year that are liable for VAT including standard rated sales, reduced rate sales, zero rated sales and other supplies.

Once you have been accepted onto the scheme you can stay on it until your total business income (including VAT) exceeds £230,000 per year.

Who cannot join the Scheme?

You cannot join the Flat Rate VAT Scheme if any of the following apply:

- You were in the scheme and left during the previous 12 months
- You are, or have been within the previous 24 months
 - eligible to join an existing VAT group
 - registered for VAT as a division of a larger business
- 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
- Your business is closely associated with another business.

Benefits of using the Flat Rate VAT Scheme

When using the Flat Rate VAT Scheme you generally see the following benefits:

- There are less reporting requirements from an accounting point of view compared to the standard VAT scheme as you do not need to report the VAT being reclaimed on purchases in your accounts. Likewise, you only have to report the percentage of VAT paid in the accounts rather than the VAT charged on each invoice
- With less reporting requirements there are less chances for errors to be made
- As you cannot reclaim VAT on purchases (see the one exemption below) the administration burden is reduced as you do not need to keep detailed records of the VAT paid on purchases made
- You receive a 1% discount on the flat rate percentage in the first year of VAT registration.



Disadvantages of using the Flat Rate VAT Scheme

Under the Flat Rate VAT Scheme you pay a fixed percentage in VAT to HMRC each quarter but cannot reclaim VAT on expenses, this could mean that the flat rate VAT scheme is not the right scheme for your business if any of the following apply to your business:

- You make a lot of zero rated or exempt sales. Even though no VAT would be charged to the customer you would still pay a fixed percentage over to HMRC each quarter and thus you could be out of pocket. Please note that sales "Outside the scope of UK VAT" are not included here
- You make a lot of standard rated purchases. If you are making a lot of purchases where VAT can be reclaimed you may lose out by being on the flat rate scheme. As a rough guide you would need to be spending approximately 13%-18% of your net income on VAT charged expenses to benefit by being on the standard scheme.

Capital Purchases

Under the flat rate VAT scheme you cannot reclaim VAT on purchases unless you are buying a capital asset in excess of £2,000 (including VAT). The following criteria must be met for a successful reclaim of VAT:

- The purchase must be a single purchase of capital assets with a VAT inclusive price of £2,000 or more. This is not restricted to a single item so multiple capital assets can be purchased i.e. a computer, printer and screen, however, they must be purchased at the same time from the same supplier on the same invoice to qualify
- It must be a purchase of a capital asset and not services i.e. assets used within the business not used up by it. A laptop and printer are capital assets (provided they are not bought for resale) where as the ink and paper are not because they are consumed by the business
- You cannot reclaim the VAT on capital assets that are intended for resale or are bought on behalf of a customer/client or are let out/leased as part of your business activities
- You cannot reclaim the VAT on building materials and building work, this is because they are not capital assets even if the expenditure includes materials.

Common flat rate VAT percentages (as from 04/01/11)

Accountancy or book-keeping	- 14.5%
Computer and IT consultancy or data processing	- 14.5%
Financial services	- 13.5%
Management consultancy	- 14.0%

Example

This is an example of how the VAT payable to HMRC is calculated under the flat rate VAT scheme.

ABC Limited trades as an IT consultancy and is in the first year of their VAT registration. For the VAT quarter 01/04/11 - 30/06/11 the company raised invoices totalling £25,000 + VAT, the VAT payable to HMRC is calculated as follows:

Gross Invoices:	£30,000	(£25,000 X 1.2)
Flat Rate Percentage:	13.5%	(1% discount as in the 1st year of VAT registration)
VAT PAYABLE	£4,050	(£30,000 X 13.5%)
Saving this quarter	£950	(£5,000 charged less £4,050 paid)

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