

Guidance on the new VAT flat rate scheme regulations

1. What is the flat rate scheme?
2. What is changing and when?
3. What are my options?

The Flat Rate Scheme (FRS)

The Flat Rate Scheme was created to simplify a business's record keeping and make it easier to work out the VAT they have to pay.

A business's VAT is normally worked out by deducting the VAT on its inputs (what they buy) from the VAT charged on what they sell (outputs).

The FRS simplifies this two stage process to just one step - a flat rate percentage of your gross turnover.

$$\begin{array}{rcl} \text{VAT charged on} & & \text{VAT recovered on} \\ \text{sales} & - & \text{purchases} \\ \text{(outputs)} & & \text{(inputs)} \\ & & = \text{standard VAT payable} \\ \\ & & = \text{flat rate VAT payable} \\ \text{Flat rate percentage of} & & \\ \text{gross turnover} & & \end{array}$$

The percentage used to determine the flat rate varies depending on the type of business and what is being sold.

You can find out what the percentages are for different businesses [here](#).

Businesses using the FRS do not deduct any tax they have incurred on their purchases (except for qualifying capital asset purchases over £2,000 including VAT). Small businesses with annual gross turnover of less than £150,000 can apply to join the FRS, and can remain until annual turnover exceeds £230,000.



Changes

From 1st April 2017, the rate to be used by limited cost traders will rise to 16.5%.

In the 2015 Autumn Statement the Chancellor announced proposed changes to the VAT Flat Rate Scheme (FRS). This is to combat concerns that some businesses were using the FRS to pay less VAT than they should.

These changes will particularly affect businesses which have a very low cost base - a '**limited cost trader**'.

HMRC defines a **limited cost trader** as one whose VAT inclusive expenditure on goods is either:

- less than 2% of their VAT inclusive turnover in a prescribed accounting period
- less than £1000 per annum if the prescribed accounting period is one year (if it is not one year, the figure is the relevant proportion of £1000)

Goods, for the purposes of this measure, must be used exclusively for the purpose of the business but exclude the following items:

- capital expenditure
- food or drink for consumption by the flat rate business or its employees
- vehicles, vehicle parts and fuel (except where the business is one that carries out transport services - for example a taxi business - and uses its own or a leased vehicle to carry out those services)
- goods purchased with the intention of being given away (like promotional materials, pens, flyers, business cards etc.)

These exclusions are to prevent traders trying to deliberately inflate their costs beyond 2%.



Options

Under the new regulations, most businesses that provide services (not goods) will be affected by the new rules.

If you're affected by this, your options will be as follows:

Convert to standard VAT accounting

This would mean that you would be able to recover the VAT on your expenses, and will almost certainly be beneficial financially. You would, however, need to prepare more detailed VAT returns, so would no longer benefit from the simple reporting with the FRS.

Remain on the flat rate scheme

Although you will be worse off remaining under the FRS, if your VAT inclusive costs are low it may be the case that the loss will be small. You may therefore choose to remain on the FRS to avoid the administrative burden of preparing standard returns.

Deregister for VAT

This will only be an option for businesses with turnover below the current VAT deregistration limit of £83,000 (from 1 April 2017), who are currently voluntarily registered to take advantage of the FRS.

Potentially broaden your range of services/purchases

There could be ways of legitimately remaining within the scheme should you increase certain expenditure to not fall foul of the 2% rule. For example, if your turnover is £100,000 and your only qualifying expenditure is stationery of £1,500 per annum you would only need to increase this by £500 to save £4,500 of VAT.

Contact us

If you would like to discuss these issues further please do not hesitate to contact us and we will be able to advise of the implications (if any) these proposals will have for your business.



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