

A QUICK GUIDE TO THE VAT FLAT RATE SCHEME

What is it? The vat flat rate scheme was launched in 2002 to simplify vat for small businesses.

Its effect is intended to be neutral, i.e. as many winners as losers in terms of vat payments.

It was updated and the rates changed from 1 January 2004

Who does it apply to? Business with a vat exclusive turnover of less than £150k.

The turnover test is based on reasonable expectations for the year ahead, and you have to leave the scheme once vat inclusive turnover exceeds £225k

How does the scheme differ to normal vat? Vat on sales (output tax) and expenses (input tax) is not accounted for separately. Instead a fixed percentage is applied to your vat inclusive turnover, eg:

Example business one vat quarter

Sales income gross	£10,000
VAT thereon (outputs)	£1,489
Expense payments to suppliers	£6,000
VAT thereon (inputs)	£894
VAT due to HMCE	£596

Suppose this business had a 9% flat rate banding.
The vat due would then be:

9% x £10,000	£900
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This business would be worse off using the flat rate scheme.

Where the scheme is in use, no separate records of output or input vat need to be maintained. A record of gross turnover is needed and, of course, income and expense records are needed for annual accounts and Income Tax/Corporation Tax returns.

VAT invoices must still be issued to customers in exactly the same way as usual, showing 17½ % vat thereon.

How do I apply? With form VAT 600, available from HMRC website (www.hmrc.gov.uk and search for vat 600)

You normally enter or leave the scheme at the start/end of a vat period. If you leave you cannot rejoin for a year. It is probably best to tie up moving into and out of the scheme with a new financial year.

Capital Assets Special rules apply if you buy equipment or other capital assets with a value of £2,000 or more including vat. In this case you can claim the vat as normal on this item as a deduction from the flat rate due.

So picking up the example on the preceding page, if the £6,000 expense payments to suppliers included £2,000 of equipment then £298 could be deducted from the £900 calculated flat rate payment, making £602 due.

What vat rate do I use? The rates are in the appendix. If your business covers two or more sectors then you use the rate applicable to the largest part of your business.

NB when assessing these rates, please remember that the rate is applied to vat inclusive turnover. It is therefore incorrect to compare the rate given to the standard vat rate of 17½% as this applies to vat exclusive amounts – the correct comparison is to 17½/117½ or 14.9% - eg

Sales of £1,000 inc vat would have vat of £149 due on them under the normal 17½% provisions. £149/£1000 = 14.9%. Input tax is recoverable as well.

If the flat rate was 10% the vat due would be 10% x £1,000 = £100 but with no input tax recovery.

1% Discount

In their first year of operation, businesses are entitled to a 1% discount off the published flat rates. This reflects higher start up costs in the first year of a business.

So is it worth while applying? Well, each business is different, and it needs to be looked at individually.

There is a ready reckoner available at <http://212.100.226.149/hmc/index.jsp> (part of HMRCs site).

Or you can do your own calculation as follows:

1. Add up your total vat exclusive turnover for the last four vat returns by adding up box 6.
2. If the total at 1 is less than £150k then you are probably eligible to use the scheme.
3. Select your flat rate band (deduct the 1% discount if in your first year) and multiply the total at 1 by this figure.
4. Add up the vat you have paid for the last four vat returns by totalling box 5.
5. If the result at 4 is more than the result at 3 then you may well be better off on the FRS.
6. To refine the calculation, if you have bought equipment costing more than £2,000 then deduct the vat you claimed on this from the total at 3.

Further information from Notice 733 available at <http://www.hmrc.gov.uk/> (enter the site and search for notice 733)

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Appendix – Flat Rates per HMCE Notice 733

Trade Sector (from 1 April 2004)	Flat Rate Percentage
Retailing food, confectionery, tobacco, newspapers or children's clothing Post offices	2
Membership organisation Pubs	5.5
Wholesaling food Farming or agriculture that is not listed elsewhere Retailing that is not listed elsewhere Wholesaling agricultural products	6
Retailing pharmaceuticals, medical goods, cosmetics or toiletries Retailing vehicles or fuel Sport or recreation Wholesaling that is not listed elsewhere	7
Agricultural services Library, archive, museum or other cultural activity Manufacturing food Printing	7.5
Repairing vehicles General building or construction services Hiring or renting goods Manufacturing that is not listed elsewhere Manufacturing yarn, textiles or clothing Packaging Repairing personal or household goods Social work	8.5
Forestry or fishing Mining or quarrying Transport or storage, including couriers, freight, removals and taxis Travel agency	9
Advertising Dealing in waste or scrap Hotel or accommodation Photography Publishing Veterinary medicine Any other activity not listed elsewhere Investigation or security	9.5
Manufacturing fabricated metal products Boarding or care of animals Film, radio, television or video production Business services that are not listed elsewhere Computer repair services Entertainment or journalism Estate agency or property management services Laundry or dry-cleaning services Secretarial services	10
Financial services Catering services, including restaurants and takeaways Hairdressing or other beauty treatment services Real estate activity not listed elsewhere	10.5
Architect, civil and structural engineer or surveyor Management consultancy Accountancy or book-keeping Computer and IT consultancy or data processing Lawyer or legal services	11
Labour-only building or construction services	11.5
	12
	12.5
	13
	13.5

* **Building or construction services**, use 'Labour-only' if the value of materials supplied is less than 10% of your turnover. If the value of the materials is more than this, builders use the 'General building' flat rate.