

Is the VAT flat rate scheme for me?

The VAT flat rate scheme (FRS) is a simplified VAT scheme that enables VAT registered business to work out how much VAT they need to pay over to HMRC by applying a flat-rate percentage to their VAT-inclusive turnover. However, VAT cannot be reclaimed on purchases (with an exception for certain capital assets over £2,000). The flat rate percentage depends on the business sector in which they operate, and also whether they are classed as a 'limited cost business' and has an 'allowance' built in for VAT on purchases.

Who can join the FRS?

A trader wishing to join the FRS must have VAT-exclusive turnover of £150,000 or less. An application to join the scheme can be made online, or by post (on form VAT600 FRS). Once in the scheme, a trader can remain in it unless, on the anniversary of joining, their turnover was £230,000 or more in the last 12 months, or is expected to be in the next 12 months. A trader must also leave the FRS if they expect their total income in the next 30 days to top £230,000.

What is the flat rate percentage?

The flat rate percentage depends on the sector in which the business operates. The percentages are available on the Gov.uk website. A discount of 1% is given for the first year that the trader is in the scheme.

Where the trader is a limited cost business, the flat rate percentage is 16.5%.

What is a limited cost business?

A limited cost business is one where the 'spend' on 'relevant goods' is either:

- less than 2% of the VAT flat rate turnover; or
- more than 2% of VAT flat rate turnover but less than £1,000 a year.

If the period is less than one year, the £1,000 threshold is proportionately reduced (so £250 per quarter).

What counts as 'relevant goods' is set out in VAT Notice 733. It includes things like stationery, gas and electricity used in the business, stock, food used in meals sold to customers, fuel used by a taxi business and suchlike. It does not include services, such as accountancy and legal fees, downloadable software, rent, postage, and fuel other than where the business is in the transport sector.

Working out the VAT to pay

One of the main advantages of the FRS is that working out the VAT to pay to HMRC is easy. It is simply a case of multiplying the VAT-inclusive turnover for the quarter by the flat-rate percentage for the business sector.

Example

Paul runs a toy shop and has done for a number of years. For a particular VAT quarter, his VAT-inclusive turnover is £22,000. His flat rate percentage for his sector is 7.5% (retail not listed elsewhere). He is not a limited cost business.

For the VAT quarter he must pay VAT of £1,650 over to HMRC (£22,000 @ 7.5%).

Advantages

The main advantage is one of simplicity. The trader does not need to keep a record of VAT on purchases. The 1% discount in the first year may generate a welcome bonus.

Disadvantages

It may be more costly being in the scheme, particularly for limited cost businesses, who get virtually no relief for any VAT they incur. The flat rate percentage for a limited cost business is 16.5% of VAT-inclusive turnover, which is equivalent to 19.8% of VAT-exclusive turnover; consequently a limited cost business pays over virtually all the VAT charged to customers to HMRC.

Is it for me?

To decide whether the VAT FRS is for you compare what you will pay under the scheme with that payable under normal rules, and factor in the added convenience of the scheme. Then weigh it up.