`Relevant goods' and the VAT flat rate scheme?

The VAT flat rate scheme is a simplified VAT scheme, which allows small traders (turnover of £150,000 excluding VAT) to account for the VAT that they pay to HMRC by reference to a percentage of their VAT-inclusive turnover.

Prior to 1 April 2017, the percentage (the flat rate percentage) depended only on the business sector in which the business operated. However, from 1 April 2017 it is also necessary to determine whether the business counts as a `limited cost business'. Where a business meets the definition of a limited cost business, the VAT payable to HMRC is calculated as 16.5% of VAT-inclusive turnover for the period rather than by reference to the (lower) flat rate percentage for the business sector. The calculation needs to be performed separately for each VAT period.

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).

Relevant goods – what counts?

Relevant goods are goods that are used exclusively for the business. Crucially, they must be `goods' not `services'. VAT Notice 733 gives the following examples of goods that count as relevant goods:

- stationery and other office supplies used exclusively for the business;
- gas and electricity used exclusively for the business;
- fuel for a taxi owned by a taxi firm;
- stock for a shop;
- cleaning products to be used exclusively for the business;
- hair products to provide hairdressing services;
- standard software provided on a disk;
- food to be used for meals for customers;
- goods provided by a subcontractor and itemised separately;
- goods brought into the UK if they are not otherwise excluded;
- goods bought without VAT being charged if they are not otherwise excluded.

The above list is not exhaustive and other goods may count as relevant goods depending on the nature of the business. Goods such as these count towards the magic 2% limit.

A person receives `goods' where ownership is passed to the business from another person or where title passes at a later date, such as goods purchased on hire purchase. The supply of water, power, heat, refrigeration, and ventilation is also a supply of goods (although hiring equipment to provide these is a supply of services).

Goods that don't count

In the main, items that are servicers rather than goods do not count as relevant goods. VAT Notice 733 contains the following list of examples of supplies that aren't relevant goods:

- accountancy fees;
- advertising costs;
- items leased or hired;
- goods not used exclusively for the purposes of the business;
- food and drink for consumption by the owner or the staff;
- fuel for a car unless the business operates in the transport sector;
- electronic devices used in the business, such as laptops and phones (which are capital expenditure);
- anything provided electronically, such as downloads;
- rent;
- downloadable software;
- bespoke software;
- stamps and other postage costs (which are payments for services).

Again, the list is not exhaustive.

Further guidance on the flat rate scheme and the limited cost business rules can be found in VAT Notice 733.