hello@broadleyaccounting.co.uk
0161 399 0028
broadleyaccounting.co.uk

Broadley Accounting

VAT Schemes
What you need to know

The Basics

This covers what VAT is, the different rates of VAT, how you register and the deadlines involved.

When you register for VAT, there are various schemes you can choose from. These schemes impact not only when you calculate your VAT but also how you calculate the VAT you need to pay to HMRC. It is important that you choose the right scheme(s) for your business.

When submitting your VAT application online to HMRC, you are given several options of VAT schemes to register for. It is important to understand what these mean and when they may be beneficial to you.

To understand the schemes, and whether you should use any of them, it is first important to understand Standard VAT.

Standard VAT

By default, when you register for VAT you are set to prepare and submit VAT returns quarterly (every three month). The VAT you pay to HMRC is calculated as:

VAT on all INVOICED sales less VAT on all INVOICED purchases = VAT due to HMRC
This essentially means that you can deduct any VAT you have incurred on valid business purchases/expenses from the VAT on your sales and pay the balance over to HMRC.

Example:

- Sales invoiced during the quarter are £10,000 + VAT; therefore, VAT of £2,000
- Purchases invoiced during the quarter are £2,000 + VAT; therefore, VAT of £400
- VAT to be paid to HMRC for the quarter is £1,600

Standard VAT - Cash basis

As a variation to this, you can choose to calculate your VAT return on a cash basis. You do not need to apply to HMRC to make this change – it is not considered a separate scheme, just an alternative way to calculate the VAT. HMRC do however say you must be consistent.

When calculating VAT on a cash basis, you only include the sales invoices that you have been in the quarter and purchases you have paid in the quarter.

This means that you only calculate VAT on the sales invoices that have been paid.

Example:

- Using the same example as above, but where you have only received payment for £5,000 + VAT of the sales invoiced
- Sales received during the quarter are £5,000 + VAT; therefore, VAT of £1,000
- Purchases paid during the quarter are £2,000 + VAT; therefore, VAT of £400
- VAT to be paid to HMRC for the quarter is £600.

Continued > > >

VAT Schemes - What you need to know

Flat Rate Scheme

The Flat Rate Scheme was introduced by HMRC to simplify VAT for small businesses. It was designed to make preparing and calculating the VAT easier and quicker to reduce the admin burden.

When using the scheme, although you still charge your client the standard rate of VAT (currently 20%), you pay over a fixed percentage of gross sales to HMRC (based on your industry), rather than offset the VAT on your purchases and expenses. This means less time is spent itemising the VAT on the expenses, and the VAT calculation takes a fraction of the time.

Until April 2017, the Flat Rate Scheme was also very beneficial to freelancers and contractors in particular as the low rates meant that it was possible to make several thousand pounds a year profit by using the scheme.

Unfortunately, HMRC realised this, and in April 2017 changed the rules for the scheme. Example pre April 2017.

Example:

- Sales invoiced during the quarter are £10,000 + VAT; therefore, VAT of £2,000 was charged
- If you are an IT Consultant, your flat rate percentage pre-April 2017 was 14.5%
- VAT to be paid to HMRC for the quarter is £1,740
- The business has effectively kept the remaining £260 of VAT.

Example pre April 2017.:

- Sales invoiced during the quarter are £10,000 + VAT; therefore, VAT of £2,000 was charged
- If you are an IT Consultant, unless you spend at least 2% of your sales each quarter on “relevant goods” (unusual), you are treated as a “limited cost trader” and your flat rate percentage post-April 2017 is 16.5%
- VAT to be paid to HMRC for the quarter is £1,980
- The business has effectively kept the remaining £20 of VAT.

The Flat Rate Scheme can still be an excellent choice if you have very little VATable expenses to claim. You may find that although you pay a little more VAT, the time saved alone makes it the preferred choice.

You must apply to HMRC to use this scheme. You can do so on your VAT application or separately at a later stage. A few eligibility points apply also:

- If you expect your turnover to be over £150,000 in the next 12 months, you can not apply.
- If your turnover exceeds £230,000 in any 12 month period, you will be removed from the scheme.

Also worth noting that as with the standard scheme, you can choose to calculate the VAT on a cash basis.

Continued > > >

VAT Schemes - What you need to know

Annual Scheme

There is an option to report VAT annually, however you have to estimate and pay VAT on account throughout the year.

This is not a scheme that we would usually recommend to any small business, freelancer or contractor.

Next steps

VAT is complicated! If you want to know more about VAT and discuss which VAT scheme may suit your business, get in touch with us at Broadley Accounting.

Let's Chat

hello@broadleyaccounting.co.uk
0161 399 0028
broadleyaccounting.co.uk

Jack Broadley Managing Director