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ACCOUNTANCY, BUSINESS AND TAXATION CONSULTANTS

factsheet

# VAT Flat Rate Scheme Changes

From 1 April 2017, if your business is on the VAT flat rate scheme, you must determine whether you meet the definition of a limited cost trader.

If you do, you will be entered onto the higher percentage of 16.5%, regardless of your trading activities. The only way to avoid this increase and continue to apply your current flat rate percentage is to show that you have incurred expenditure on **qualifying goods** in excess of £1,000 per annum (or 2% of your VAT inclusive turnover if that's higher).

Qualifying goods must not have any element of personal use and cannot include any of the following:

- Capital goods which are used over a period of time (i.e. computer/office equipment)
- Food or drink
- Vehicles, vehicle parts and fuel
- The cost of services (i.e. accountancy/professional fees)

As this leaves little in the way of expenditure items that you would normally incur in order to avoid the increase, the likelihood is that you will need to adopt this new percentage from 1st April 2017.

The illustration below shows the impact this will have to a company with contracted income of £50,000, operating within the engineering sector (flat rate percentage is 14.5%):

	Limited cost trader – 16.5%	Engineering sector – 14.5%
Contracted income	£50,000	£50,000
VAT (20%)	£10,000	£10,000
VAT inclusive income	£60,000	£60,000
Flat rate payable to HMRC	<u>(£9,900)</u>	<u>(£8,700)</u>
Flat rate gain	£100	£1,300

*For this business, the changes will reduce the company's income by £1,200 p.a.*

## What are your options going forward?

### 1. Remain on the Flat Rate Scheme

Firstly, there isn't a necessity to leave the scheme. If you decide to continue using it your income is likely to decrease, however we will continually assess your expenditure each quarter and if you incur enough on qualifying goods, we will apply your lower sector percentage.

It is also important to remember:

- The Flat Rate Scheme is designed to make VAT administration easier as you don't need to keep record of the VAT you have incurred on expenses.
- A reduction of 1% will still be available where you are still within your first year of VAT registration. In the above example a first year percentage of 15.5% would see a flat rate gain of £700.

Our advice: This option will be best for businesses who are in their first year of VAT registration, or those who will meet the qualifying goods criteria.

### 2. Leave the scheme and operate the standard VAT method

Alternatively, you can choose to leave the Flat Rate Scheme and revert to operating the standard method for VAT.

Under the standard method, you will charge VAT to your client as normal. All of the VAT that you receive from your client will be payable to HMRC, but you then benefit by being able to claim back the VAT you incur on the majority of your business expenses.

Using the example earlier, let's assume that the business has incurred VAT inclusive expenses in the year of £4,000 on costs such as capital items, office equipment and accountancy fees. By switching to the standard VAT method, they would be able to claim back VAT from HMRC of £667. The business would then be £557 better off under the standard method than the Flat Rate Scheme.

Please note, when operating the standard VAT method, you must ensure that you have a valid VAT receipt for all business expenses.

Our advice: This option will be best for businesses that do not meet the qualifying goods criteria but do incur expenditure where VAT has been applied.

### 3. De-register from VAT

If your annual turnover is less than the de-registration threshold (currently £81,000), you have the option to de-register from VAT completely.

By de-registering, you will no longer have the burden of ensuring that quarterly VAT returns have been filed and payments made before the respective deadline. However, you will lose out on any potential profit on either the flat rate gain, or claiming back VAT on the expenses you have incurred.

Our advice: This option will be best for businesses that have a low turnover and do not incur much in the way of business expenditure or make supplies to non VAT registered persons.

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