

## Contractors' guide to the flat rate VAT scheme

Contractors who work through [contractor limited companies](#) in certain sectors and who opt for the flat rate VAT scheme can significantly reduce their administrative burden and, in some cases, even end up with a cash surplus.

The [flat rate scheme](#) was introduced by HMRC in 2002 to simplify paperwork for small businesses when accounting for [VAT](#). Contractor limited companies that turn over less than £150,000 excluding VAT in any financial year are eligible for the scheme.

It means that contractors can charge clients 15% VAT as normal, but when they come to reconcile their VAT, they pay HMRC a percentage of turnover, rather than working out the VAT on all purchases.

### Simplified VAT accounting

Contractors who are used to processing their VAT returns every quarter will be pleasantly surprised by the low level of bureaucracy required for processing their flat rate return. Instead of a quarterly return the VAT can even be reconciled annually.

When [invoicing](#), contractors should charge the standard 15% VAT rate to their clients or agency. The VAT will accumulate during the course of the year, and contractors should ensure they keep this cash ring-fenced so they can pay HMRC the amount when required.

Let's say an engineering contractor, a civil engineer, bills £70,000 to their client or agency during their financial year. VAT at 15% on this turnover would be £10,500, so turnover plus the VAT into the business is £80,500.

The VAT to pay out to HMRC using the flat rate scheme is 11% of total income including VAT (11% is the HMRC rate for civil engineers – other examples will have different rates) of the contractor's turnover including VAT. This works out as 11% of £80,500 which is £8,855.

The contractor pays £8,855 to HMRC at the end of the year in their flat rate VAT return, which leaves £1,645. For most contractors in the IT, engineering and construction sectors with reasonable expenses, this amount more than compensates for the VAT paid out in company purchases.

### Flat rate exceptions and allowances

The flat rate scheme can work against contractors who do have a large number of VAT rated transactions, as the returns they can expect are limited because of the flat rate. However, there is a mechanism to account for large purchases.

New contractors who opt for the flat rate can benefit from a one per cent reduction in the flat rate percentage for the first year of their registration. This discount still applies if HMRC changes the rate during the first year of registration.

The flat rate is applied to all 'supplies' a business makes, which includes not just fees from clients but bank interest and any income from things like rent from properties and selling assets of the business.

For capital expenditure over £2,000, say for a vehicle or high end computer hardware, then the VAT can be claimed on these specific items using the annual VAT return. Seriously expensive kit might result in the contractor having to leave the flat rate scheme.

What rate should contractors pay?

The flat rate VAT percentages in force since 1 December 2008 for key contracting sectors include:

- o Computer and IT consultancy – 11.5%
- o Civil and structural engineers – 11%
- o Architects and surveyors – 11%
- o Management consultants – 11%

A full breakdown of the flat rate VAT scheme percentages can be found on the [HMRC website](#). This also includes a catch-all rate for 'Business services that are not listed elsewhere' of 9.5%.

### How can contractors join the scheme

[First-time contractors](#) should think about how much they plan to earn in their first year of trading and, if this is likely to exceed the current VAT threshold of £67,000 turnover per year, then joining could be a good move.

Existing contractors can also join the scheme and could benefit from not only the reduced paperwork, but also the potential cash bonus at the end of the year.

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