

The flat rate VAT scheme - should contractors join?

The Flat Rate VAT scheme was introduced in Budget 2002 and is available to all small businesses. This article explains the scheme and shows how to determine whether it is advantageous to join.

What is the Flat Rate Scheme?

The scheme provides an alternative to the normal method of VAT accounting.

The normal method is based on the 17.5% standard rate on services provided (output VAT) and deducting from that the VAT incurred on purchases (input VAT). The exact amount of net VAT is accounted for to HMRC on a quarterly basis.

With the Flat Rate Scheme you pay VAT as a percentage of your turnover instead of working out VAT on all purchases. The percentage varies according to the category of your business.

How will the scheme help me?

- o Simplify your accounting - less time keeping VAT records and calculating VAT payable.
- o Potentially increase your profits, depending on levels of VAT purchases.

Who can join the scheme?

You can join the scheme if within the next 12 months:

- o your annual taxable turnover (not including VAT) does not exceed £150,000; and
- o your total turnover (not including VAT) will not be more than £187,500.

Claiming back VAT

Under the scheme you do not normally claim back VAT, since the flat rate takes account of VAT you have paid to your suppliers.

However, you can claim for any single capital asset costing £2,000 or more.

Should contractors join?

The answer is "probably yes", although it depends on your category of business, the level of turnover and also on the amount of VAT purchases you incur.

Let's take an example for an IT contractor who would fall into category of 'Computer and IT Consultancy' with a fixed rate of 13%.

Company annual revenue = £100,000. Thus, VAT = £17,500.

Flat Rate percentage = 12% (discounted 1% for the first year).

VAT to pay = £117,500 x 12% = £14,100.

Difference = (£17,500 - £14,000) = £3,400.

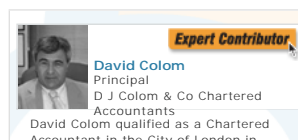
The £3,400 surplus is retained as profit. Any VAT on accountancy fees, computer consumables, etc., is not recoverable and therefore reduces the surplus.

For a typical contractor earning between £50,000 and £100,000 per year, there is likely to be a surplus arising of at least £2,000. This will reduce in the second year as the 1% reduction to the standard rate of flat rate expires and the usual rate of 13% will apply. In the above example with no input VAT, the surplus would be reduced from £3,400 to £2,225.

In broad terms, the higher your sales turnover, the more likely it is to be beneficial for you to join the flat rate scheme as an IT contractor with minimal VAT'able inputs. For other industries, you will need to find your rate from the [HMRC website](#) and do your own calculation.

How do I join the scheme?

The simplest way to join is to call the VAT advice line on 0845 010 9000, who will be able to take your VAT registration number and relevant details on the telephone, following which you will be registered after approximately 21 days.



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Alternatively, you can download the scheme application form from [HMRC](#) .

Updated: Thursday, January 06, 2011

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