

## 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 for VAT was introduced by HMRC in 2002 to simplify paperwork for small businesses when accounting for VAT," explains [James Abbott](#), owner and head of tax at contractor accountant [Abbott Moore](#).

"Contractor limited companies that turn over less than £150,000, excluding VAT, in any financial year are eligible for the scheme. Once in the scheme, contractors won't be forced to leave until their VAT inclusive turnover exceeds £230,000."

It means that contractors can charge clients 20% 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.

### What are the advantages of the VAT flat rate scheme?

One major one is simplified VAT reporting. "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," continues Abbott. "When invoicing, contractors should charge the standard 20% VAT rate to their clients or agency. The VAT will accumulate during the quarter, and contractors should ensure they keep this cash ring-fenced so they can pay HMRC the amount when required."

Abbott explains further: "Let's say an engineering contractor, a civil engineer, receives £30,000 plus VAT from their client or agency during their VAT quarter. VAT at 20% on this turnover would be £6,000, so turnover plus the VAT into the business is £36,000."

The VAT to pay out to HMRC using the flat rate scheme is 14.5% of total income including VAT (14.5% is the HMRC rate for civil engineers – other types of contractor will have different rates). This works out as 14.5% of £36,000 which is £5,220.

The contractor pays £5,220 to HMRC at the end of the end of the month following the quarter end stated on their flat rate VAT return, which leaves £780. 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. Simplicity of reporting alone is the biggest reason for contractors to seriously consider the VAT flat rate scheme – it can save you and your accountant a lot of time and effort, which will in turn save you money.

### Flat rate VAT exceptions and allowances

But, like every good thing from HRMC there are issues to keep in mind when considering whether to use the flat rate VAT scheme. According to Abbott, the scheme won't benefit all contractors: "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 of capital goods."

New contractors who opt for the flat rate VAT can benefit from a one per cent reduction in the flat rate percentage for the first year of their VAT 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 also any income from things like rent from properties and selling assets of the business," Abbott says. "HMRC has traditionally held the view that it should be applied to bank interest received too, although a VAT tribunal decision has called that into doubt.

For capital expenditure over £2,000, say for high end computer hardware, then the VAT can be claimed on these specific items using the annual VAT return.

### What VAT rate should contractors pay?

The [HMRC flat rate VAT percentages](#) (as at tax year 2013/2014) for key contracting sectors include:

Computer and IT consultancy or data processing – 14.5%

Architect, civil and structural engineer or surveyor – 14.5%

Management consultancy – 14%

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 12%, but it would be unusual for the average contractor to fit into that catch-all category.

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James Abbott, Abbott Moore LLP

This is because HMRC states in its VAT Notice 733 that, 'If you act as a consultant and you do not fit into another specific sector, you should choose Management Consultancy. This sector is not restricted to businesses that fit the traditional idea of management consultant.'

## How can contractors join the flat rate VAT scheme?



**James Abbott**

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James Abbott is the owner of Abbott Moore LLP and often speaks on freelancer / contractor tax matters. He has his own growing portfolio of contractor clients.

Abbott Moore LLP are PCG Accredited Accountants and specialise in providing tax advice to freelancers as well as dealing with their year end accounts and tax returns. [Read Full Profile...](#)

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"Before joining the VAT flat rate 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 £77,000 turnover per year, then joining could be a good move," says Abbott. "It may even be worth considering voluntarily registering for VAT even if a contractor's turnover is below that level."

Existing contractors can also join the scheme and could benefit from not only the reduced paperwork, but also the potential 'profit', too.

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